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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

Nos. 11-19

IN THE MATTER OF

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,

Debtor.

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP,

Petitioners,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, ET AL.,

Respondents.

REPLY BRIEF OF GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS.

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October 12, 1942.

THE BLAKEMORE-WARREN PRINTING COMPANY, 220 WEST JACKSON, CHICAGO

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REPLY BRIEF OF GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS.

STATEMENT.

Briefs of respondents in part attack and in part seek to support the decision of the Circuit Court of Appeals. Those representing stockholder interests challenge its affirmation of the District Court and the Commission in determining that the equity of the stock is without value. Those representing certain of the creditor interests support the reversal of the District Court and the remanding of the case

to the Interstate Commerce Commission. In this reply brief we discuss the several briefs for respondents and group these briefs for this purpose, as follows:

I. Briefs of Stockholder Interests
   (a) Brief for *Amicus Curiae*
   (b) Brief of Debtor
   (c) Brief of Protective Committee for Holders of Preferred Stock of Debtor

II. Briefs of Various Creditor Interests
   (a) Brief of Trustee of General Mortgage
   (b) Brief of Certain Holders of General Mortgage bonds
   (c) Brief of Trustees of Fifty Year Five Per Cent. Mortgage and Protective Committee for Holders of Fifty Year Five Per Cent Mortgage Bonds
   (d) Brief for Terre Haute Creditors
   (e) Brief of Certain Holders of Convertible Adjustment Mortgage Bonds
   (f) Brief of Trustee of Chicago, Milwaukee and Gary Mortgage

Petitions for certiorari of the several respondents were not granted. The issues raised and argued by certain of these parties in their briefs are primarily the issues which they sought to bring before the Court by their own petitions. It may be questioned at the outset whether those issues are here. See *Connecticut Railway & Lighting Co.* v. *Palmer*, 305 U. S. 493 (1939).

In the courts below there was practically no contention that there was any inadequacy in the Commission's findings. It was clear to all, both what the Commission found, and the reasons for its conclusions. The argument was on the merits—the validity of the Commission's conclusions. But here—to take full advantage of the decision of the Circuit Court of Appeals, which virtually raised the issue as to the sufficiency of the findings *sua sponte*, the briefs of respondents have one common reliance. They contend

that the determinations of the Commission and the District Court approving the plan of reorganization were inadequate in their statement of "findings" or "reasons". For the convenience of the Court, we have collected, in Appendix A to this brief, the record references to the evidence introduced before the Commission and the District Court, respectively, considered in their decisions on the following subjects which constitute the primary basis of the plan: Capitalization and capital structure of the reorganized company; lack of value in the stock; permissible fixed charges; additions and betterments fund; and allocation of the new securities among creditor groups, including the option provided for Terre Haute bondholders. Appendix B collects the record references to many of the reasons stated by the Commission and the District Court, respectively, for the conclusions concerning each of these subjects. The full record and the careful consideration accorded the complex issues presented is graphically demonstrated by these appendices.

The Respondents and the Interests Which They Represent.

The respondents may be briefly identified as follows:

Certain holders of General Mortgage bonds in the total principal amount of $4,952,000, some of whom were permitted to intervene in the proceeding before the District Court. None of them appeared before the Commission at any time during the five-year period that the plan was in the process of formulation before that body. (R. 1420) Bonds are outstanding under the General Mortgage in the principal amount of $138,788,000. (R. 2166)

A protective committee for the holders of the Fifty Year 5s representing approximately $1,500,000 in principal amount of these bonds appeared in the proceeding before

the Commission and the District Court. These bonds are outstanding in the principal amount of $106,395,096. (R. 2172)

Three holders of Gary Mortgage bonds in the aggregate principal amount of $23,000. (R. 1355) These bonds are outstanding in the principal amount of $3,000,000. (R. 2170)

Several holders of Adjustment bonds, having the most junior lien on the property, in the principal amount of $31,500. (R. 1938) These bonds are outstanding in the principal amount of $182,873,693. (R. 2172)

The Chicago, Terre Haute and Southeastern Railway Company, certain committees and individuals representing or holding approximately $5,613,000 in principal amount of various of the four issues of Terre Haute bonds which are outstanding in the principal amount of $21,929,000, and the respective mortgage trustees under those four bond issues, objecting as to the treatment in the plan of the Terre Haute lease to the debtor of the line from Chicago Heights to Westport, Indiana. (R. 1317, 1439, 1719)

The attack upon the plan of each of these interests, except one, is supported by the trustee or trustees of the respective mortgages.

Stockholders of the old company are represented here by the debtor and a preferred stockholders committee.

The Petitioners and the Interests Which They Represent.

The Reconstruction Finance Corporation, which is the petitioner in No. 32, is a creditor of the debtor in the amount of approximately $11,947,164 as of the date of certification of the plan. (R. 1317)

The petitioners on whose behalf this reply brief is filed are the Group of Institutional Investors, consisting of

eleven life insurance companies, and the Mutual Savings Bank Group, consisting of approximately one hundred and fifty savings banks, as stated on page 2 of our original brief. The combined holdings of these fiduciary institutions are $83,653,000 principal amount of the debtor's bonds.[1]

Henry A. Scandrett, Walter J. Cummings, and George I. Haight, Trustees of the property, have also filed a brief in support of the plan as constituting a practical, workable basis upon which the property may be operated economically and in accordance with the public interest. (See also R. 1867).

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[1] The holdings of the Groups in each issue of the debtor's bonds are as follows:

Chicago, Milwaukee & St. Paul Railway Company General Mortgage Bonds ($138,788,000 outstanding)	$55,756,000
Milwaukee and Northern Railroad Company First Mortgage Bonds ($2,117,000 outstanding)	1,210,000
Milwaukee and Northern Railroad Consolidated Mortgage Bonds ($5,072,000 outstanding)	1,277,000
Chicago, Milwaukee, St. Paul & Pacific Railroad Company Fifty Year Five Per Cent. Mortgage Bonds ($106,395,096 outstanding)	9,106,200
Chicago, Milwaukee & Gary Railway Company First Mortgage Bonds ($3,000,000 outstanding)	1,200,000
Chicago, Milwaukee, St. Paul & Pacific Railroad Company Convertible Adjustment Mortgage Bonds ($182,873,693 outstanding)	15,103,800
Total ($438,245,789 outstanding)	$83,653,000

(The principal amount only, exclusive of the accrued and unpaid interest, is shown above in all instances. The holdings of the member companies of the Group of Institutional Investors and the Mutual Savings Bank Group are stated as of February 26, 1941, and April 7, 1941, respectively.)

I.

BRIEFS OF STOCKHOLDER INTERESTS.

A. Brief for Amicus Curiae.

Counsel representing debtors in five other pending railroad reorganization proceedings, wherein the Commission also found the equity of the stockholders in the bankrupt companies to be without value, has filed a brief herein as *amicus curiae*. It is contended that the reorganization plan approved by the Commission and the District Court is unlawful in not permitting the old stockholders to share in the distribution of securities of the reorganized company.

Counsel for *amicus curiae* contends (1) that by virtue of Section 77 the debtor occupies a peculiarly impartial position in the reorganization process which somehow should be preserved; (2) that the Commission's plan as approved by the District Court is vitiated by failure of both of those tribunals to state the "reasons" for their conclusions as differentiated from "findings"; (3) that Section 77 does not require a reduction in capitalization of the reorganized company, but instead that the maintenance of railroad credit requires that such reduction in capitalization be avoided; (4) that increased railroad earnings incident to the war constitute such a change in fundamental conditions as to create a different economic era; and (5) that the record upon which this Court must review the action of the Commission and the District Court is stale and not indicative of conditions which should now be considered.

The arguments advanced to support these propositions have no foundation in the record in this proceeding. Instead, wholly aside from their legal frailities, they are completely refuted by the facts of this case.

1. In the present proceeding, the "debtor", far from being the impartial representative of all parties in the public interest, as pictured by counsel for *amicus curiae*, has sought for the past five years to delay rather than to promote the reorganization of this railroad. In 1937, after the Commission had been studying the moratorium plan which the debtor had submitted with its bankruptcy petition in 1935, the debtor withdrew its support of that plan, characterized it as no longer feasible, and presented motions and arguments of counsel and testimony of its directors to the effect that no reorganization was possible under the then uncertainties of general business conditions. Debtor declined to predict when such a reorganization might properly be consummated, and instead actually permitted the record before the Commission to be closed on September 20, 1937, without having presented any substitute plan which the Commission might consider. (R. 586-592, 635, 2187) This it did in spite of the duty laid upon it by Section 77 to file a plan of reorganization within six months after the filing of its petition to reorganize, which presumably means the filing of a feasible plan.

It was only upon petition of the creditors composing the groups of institutional investors that the proceeding was reopened so that in view of the debtor's default they might present a proposed plan of reorganization. Thereafter, committees representing stockholders sought further delay. (R. 592) Late in 1938, while the Commission was preparing its final report, after the matter had been submitted to it upon the proposed report of its Examiner and upon the briefs and argument of counsel, a committee for holders of the preferred stock of the debtor joined with committees of stockholders of the Chicago and North Western Railway Company seeking to have the record in both reorganization proceedings reopened for the purpose of considering a plan of consolidation of these two

railway systems. (R. 1249) The Commission found this effort for further delay to be without merit, and denied the petition. (R. 1249-1254). Delay was again sought by the committee for the preferred stockholders of the debtor in October, 1939. (R. 1256)

For years the debtor and other representatives of the old stockholders thus have been counseling delay in reorganization and urging that the conditions existing at the time did not permit the making of a sound plan. Meanwhile, the unpaid interest continued to accrue in the amount of $118,878,918 up to January 1, 1939, which the Commission found should be the effective date of its reorganization plan, and since that time at the rate of approximately $23,601,000 annually. On July 1, 1942, the total accrued and unpaid interest, taking account of payments made upon the approval of the District Court, amounted to $172,815,955.[1]

2. The assertion that the decisions of the Commission and the District Court should fail for an allegedly inadequate recital of reasons ignores the extensive "reasons" and "findings" stated at length by both these tribunals. The Commission, in its first report of 114 printed pages accompanying the plan, devoted 58 pages to these matters under the heading "Discussion and Conclusions." (R. 2212-2269) Its supplemental report, containing further "findings" and "reasons", covers 32 additional printed pages. (R. 1286-1317) The opinion of the District Court is likewise extensive and complete, covering 43 pages of the printed record. (R. 1857-1899). Seldom are tribunals so meticulous and careful to set forth fully the basis of their conclusions as were the Commission and the District Court in this proceeding. The attack upon the plan on this score wholly ignores the realities of the case.

[1] Of this total, $60,501,028 was for fixed interest accrued and not paid and $112,314,927 was for contingent interest accrued and not paid.

3. The contention that the old capitalization should have been retained likewise ignores the facts of record here. The Commission and the public had too vivid a recollection of the results of that kind of a reorganization in respect of this same railroad to approve a repetition. The 1928 reorganization of this debtor not only preserved the prior capitalization, but increased it slightly from $698,974,875 to $707,651,549 (see page 7, our original brief). Seven years later, the reorganized company, after having failed to earn its bond interest for several years, was back again for another reorganization. Meanwhile, the criticisms of the 1928 reorganization methods and results, including the failure to reduce capitalization, had caused Congress to enact Section 77 of the Bankruptcy Act, with its directives to the Commission in respect to adequate coverage of fixed charges, the alteration of the rights of creditors and stockholders, and the making of a plan of reorganization compatible with the public interest. Congress recognized that determination of the permissible capitalization, capital structure and participation therein is the objective of the entire reorganization process and provided for the alteration of the rights of creditors and stockholders "through the issuance of new securities of any character or otherwise." (Sec. 77(b) (1) and (2)) The aggregate amount and character of the new securities issued under the plan for allotment to the existing security holders necessarily fixed the amount of the total capitalization.

4. The increase in railroad earnings from military traffic has not altered the fundamental facts upon which a plan of reorganization must be based and which the Commission considered. War-time earnings cannot revivify the rights of stockholders which have been lost long before. As the Commission declared, it was under a duty "to devise a plan that will serve as a basis for the company's financial structure for the indefinite future." (R. 2220)

The illusory nature of war-time earnings has been pointed out in our original brief (pp. 61-62). Such earnings do not constitute any change for the better in fundamental conditions, nor do they depict a new economic plateau. Increased war-time earnings, which are wholly insufficient to pay off unpaid interest of more than $170,000,000 accrued during prior successive years of deficit operations, cannot be relied upon to reestablish value in the stock.

But aside from this, the reference to alleged increased earnings of the debtor for 1941, as set forth on page 43 of the brief for *amicus curiae*, ignores the material facts. It is there said:

> "In 1941 the actual gross earnings of the St. Paul were $139,646,000 and the net over $28,939,000."

For 1941 the Trustees of the debtor filed monthly reports with the Circuit Court of Appeals pursuant to its order of September 23, 1941, and these are a part of the record transmitted to this Court and were, as the Circuit Court of Appeals expressly stated, considered by it in affirming the decision of both the Commission and the District Court that the old stock has no value. (R. 2311) In computing the net earnings which counsel says amounted for the year to $28,939,000, no deduction was made for Federal income taxes, nor was consideration given to the wage increases which were made on December 1, 1941, retroactive in part to September 1, 1941.

Since fixed and contingent interest charges, as provided in the Commission's plan, amount to $9,489,134 annually, the difference between this figure and the $28,939,000 is $19,449,866. If this difference were subjected to a normal corporate income tax and surtax of 31%, the rate in effect for 1941, the deduction would be $6,029,458, without giving effect to excess profits tax, if any. Even then the Commission could not have used the resulting figure of $22,909,542 as a predictable net income in formulating a plan of reorganization without also taking account of the fact that

on December 1, 1941, wage increases amounting to more than $6,500,000 annually were made. Likewise, at the present time the debtor is faced with demands for large wage increases from its operating and non-operating employees, and is also confronted with the necessity of meeting increased normal and excess profits Federal taxes under tax legislation for the year 1942 which has not yet been enacted.[1]

These essential considerations show the impropriety of assuming that war-time earnings have permanency or even reality. There is no indication whatever that a new economic level has been attained or that there has been any change in fundamental conditions which vitiates the Commission's plan.

5. The record upon which the District Court approved the Commission's certified plan was closed on September 9, 1940. (R. 1795) Full opportunity was given all parties to present oral and documentary evidence. The period which has since elapsed has been taken up with proceedings on appeal to the Circuit Court of Appeals and on review to this Court. As previously noted, the Circuit Court of Appeals, during the pendency of the appeal, required the filing with it by the trustees in bankruptcy of monthly earnings statements of the debtor. The decision of the Circuit Court of Appeals was rendered on December 4, 1941, and its denial of motion to modify its opinion was on January 12, 1942.

[1] The corporate tax rates (normal, surtax and excess profits) in the pending revenue bill remain undetermined at this writing. Current wage demands of the non-operating railroad unions, as published on September 25, 1942, are for an increase of 20c per hour with minimum pay of 70c per hour. In response to our request the assistant to the Trustees of the debtor estimates that such an increase in wage rates, if in effect for 1941, would have amounted to $12,501,686, and for the first seven months of 1942 would have amounted to an increase in payroll in the amount of $7,882,776. There are also pending the demands for increased wage rates of engineers operating Diesel electric locomotives and of firemen on all locomotives.

If in these circumstances a record on review becomes stale so as to require remission to the Commission, it simply means that railroads cannot be reorganized under Section 77. There will always be changes in conditions in the railroad industry as well as fluctuations of earnings. A reorganization designed to achieve some permanence, such as the Commission here sought, cannot be based upon a temporary situation. It must be predicated, as this was, upon the results of operations over a long period of years. Temporary changes must be evaluated in the light of long-term trends.

The Commission well stated that "refusal by us to approve any plan until present uncertainties are resolved and the earning-power of the system is stabilized would be to delay the reorganization indefinitely." (R. 2220) That was in January, 1940. Now almost three years later, after the creditors have foregone large additional amounts of unpaid interest, the plea of the debtor for delay is once again repeated. We are now informed by counsel that "there will certainly be a considerable period after the war when railroad traffic will remain at high levels due to the tremendous wastage of the war." (Brief, *amicus curiae*, p. 44) The motor truck again operating on the highways, the freighter in coastal waters and on inland waterways, and the airplane developed by war-time necessity as never before to perform transport service, are completely ignored.

Congress enacted Section 77 to expedite railroad reorganization. This Court on at least two occasions has so observed. *Continental Bank* v. *Rock Island Ry.*, 294 U. S. 648, 685 (1935); *Palmer* v. *Massachusetts*, 308 U. S. 79, 85-86 (1939). It is significant that within the past few weeks the Judiciary Committee of the House of Representatives and the Committee on Interstate Commerce of the Senate, in recommending emergency legislation (H. R. 7121) for voluntary adjustment of obligations of railroads

not requiring reorganization, again recognized and declared that the public interest required prompt reorganization. Thus the Senate Committee in Report No. 1617, dated September 28, 1942, adopted the previous report of the House Committee (H. Rept. No. 2177, 77th Cong. 2d Sess.), in which it was specifically stated that the emergency legislation permitting voluntary adjustments did not supersede Section 77. On the contrary the report declared:

> "Where a railroad company is so burdened with a heavy capital structure that it is in need of thoroughgoing reorganization, it is not in the public interest, nor even, except temporarily, in the interest of the company itself, that such a reorganization be postponed. It is not the intention that this legislation afford a means of avoiding reorganizations in such cases." (p. 5)

The retention of stock interests at the sacrifice of the rights of creditors even by way of voluntary adjustment was condemned, the report, at page 4, declaring:

> "It is not contemplated that any plan of adjustment can be approved by the court for railroad companies where the continued participation of stockholders in the company can be maintained only at the sacrifice of substantive rights of creditors."

Further, and especially pertinent to the argument of counsel for *amicus curiae* here is the declaration at page 3 of the report that the existence of the war, instead of constituting a reason for delay, makes the consummation of prompt railroad reorganization doubly essential:

> "This bill, it is thought, can render material aid to the national war program. The seriousness of the war in which our country is engaged and the vital role transportation is playing in the conduct of the war now makes it imperative that our transportation system be preserved and maintained in the most efficient state and that the carriers themselves be placed on a sound financial basis so as to enable them to meet the unusual demands which are being and will be imposed upon them."

In a word, the committees of both branches of Congress, to whom problems involving the reorganization of railroads have been duly entrusted by Congress, have replied directly to all the propositions now urged by counsel for *amicus curiae*.

B. Brief on Behalf of Debtor.

The brief filed on behalf of the debtor covers much the same ground as the brief of *amicus curiae*. Debtor, although a respondent here, seeks to attack the decision of the Circuit Court of Appeals in affirming the District Court's approval of the Commission's determination that the equity of stockholders is without value.

Debtor now relies upon (1) alleged restoration of earning power to a level sufficient to revivify the equity of the excluded stockholders, and (2) alleged technical defects in the Commission's reports as invalidating the exclusion of the old stock.

Before the Commission, the debtor conceded that the stockholders had no equity unless it could be predicated upon physical valuation or increased future earnings of the property. This is recited in the Commission's report:

> "The debtor's Board of Directors recognizes the fact that the present stockholders have no equity in the property on the basis of its present earning power, but on the basis of the Section 19a valuation and the reported elements of value, the Board believes that an equity exists, at least in the preferred stock. It further believes in the possibility that earnings will increase in the future to the extent that both the common and preferred stock would represent value." (R. 2201)

The earnings now relied upon as demonstrating error in the determination of the Commission, the District Court and the Circuit Court of Appeals are the war-time earnings of 1941 and 1942. We have previously pointed out that the 1941 war earnings which were considered by the Circuit

Court of Appeals, made no allowance for Federal income taxes, either normal or surtax, much less excess profits taxes, and also failed to give consideration to the effect of increased wages. (pp. 10-11) In the face of this evidence, the Circuit Court of Appeals sustained the District Court and the Commission. (R. 2310)

Counsel for the debtor now argues that these war-time earnings of 1941 are to be viewed as normal earnings and that Federal taxes may be ignored. This it is said follows because "taxes do not permanently reduce earning power." (Debtor's brief, p. 25)

In our original brief we recited the earnings experience of this railroad during the World War period of 1914-1918, and its aftermath. (Our original brief, pp. 61-62) There is nothing in the present national situation that indicates any different general pattern as to railroad earnings. The volume of traffic tends to increase ahead of expenses, but expenses soon catch up and eliminate ostensible profits, even to the point of turning them into losses. Taxes, both State and Federal, rise, wage rates increase, and all costs of operation tend to go up. It is an extreme proposition that railroad companies will be permitted, despite economic law and Congressional revenue legislation, greatly to enhance their net available for interest and dividends, while the earnings of other corporations and individuals are curtailed. While debtor now rests its case upon the earnings from war-time traffic, it would eliminate from consideration the effect of the present high tax rates notwithstanding the fact that basically both the increased gross earnings and present tax level have their source in the same conditions.

Unlike the debtor, the creditor interests, respondents herein, recognize the effect of Federal taxes to be practical rather than theoretical. For example, the Fifty Year Five Percent bondholders, complaining of the allotment to them of new preferred stock, say:

"* * * because of the tax burdens occasioned by the conversion of debt into stock, it is estimated that the full dividend cannot be paid on the preferred stock of the reorganized company out of earnings as great as those for the calendar year 1941 (approximately $28,900,000 available for interest), and no dividend can be paid therefrom on its (new) common stock." (Brief of the Fifty Year 5s, p. 17)

The need for reorganization of this railroad company had its origin three decades ago. As was noted at page 63 of our original brief, no dividends have been paid on either the common or preferred stock since 1917. The dividends paid between 1911 and 1917 were not paid out of current income but were distributions of surplus. (131 I. C. C. 615 at 626) In the World War period, the earnings of debtor's predecessor rose to $30,896,302 in 1916, but dropped almost immediately, so that in 1919 they were only $1,969,322. In 1920 there was an operating deficit of $14,497,698. (131 I. C. C. 673 at 715) In the next few years the company kept going only by means of loans from the Federal Government, and by 1925 its indebtedness to the United States Government amounted to $55,000,000, evidenced by six per cent notes in the amounts of $25,000,000, $10,000,000 and $20,000,000, respectively, and collaterally secured by the pledge of bonds. (131 I. C. C. 673 at 681) Its inability to pay this and other debts resulted in the equity receivership of 1925 and in the reorganization of 1928. Funds to pay the Government debt, the Government notes, and for working capital and the expenses of receivership and reorganization, totalling $70,932,548, were raised by the old stockholders. For their contributions of $28 per share on the preferred stock and $32 per share on the common stock they received new Fifty Year Five Per Cent. Mortgage Bonds in the principal amount of $24 for each share of preferred stock and $28 for each share of common stock, and in addition, one share of new stock of the class on which the assessment was paid. (131 I. C. C. 673 at 681)

Thus, the reorganized company came out of the 1928 receivership with a larger debt and a larger capitalization than when it went in.

The reorganized company had good earnings in the boom years of 1928 and 1929, and then its earnings began to drop, so that in 1930 it failed to earn its fixed and contingent interest, and beginning with 1931 failed to earn its fixed interest. In 1932 it reported an operating deficit. Again it borrowed from Government agencies, this time from the Reconstruction Finance Corporation. In no year during the decade of the 30's did it earn anywhere near the interest charges on its debt. (R. 2180) The officials of the road contemplated reorganization three years before the present proceedings were commenced in 1935. (R. 456) This long record of the failure of earnings to support the capital structure conclusively demonstrates the need of a radical reorganization. It cannot be overcome by sporadic earnings attributable to war-time conditions or to boom years.

In Part IV of its brief, the debtor presents three technical objections as showing alleged invalidity of the Commission's plan. The first of these is the claim that there was no adequate segregation formula in the record for allocating earnings and expenses among the several mortgage divisions. Reliance is placed upon the self-serving statement of counsel who represented the debtor during the proceedings before the Interstate Commerce Commission to the effect that the record was inadequate in this respect. The same counsel, in replying to a request of the Interstate Commerce Commission for additional earnings studies to be compiled by the Trustees of the debtor from the corporate records, stated, as reported at pages 574-575 of the record:

> "For reasons which Mr. Scandrett will presently explain, the Debtor is unable to furnish that information in the form requested, because no accounts are kept on the basis of separate operation, and separate

operation involves so many hypotheses that are wholly problematical that it is quite impossible to supply precisely that request; but, we have prepared information which I take it will serve the purpose of the Director, that is, the allocation of the actual earnings of the property, as they are presently operated, assuming their continued operation as a part of the St. Paul System;—the allocation of earnings to the various lines requested, and I offer as Exhibit No. 139 a statement showing the allocation of actual revenues, expenses and net income to the Terre Haute Lines for the year 1936, and as Exhibit No. 140 a copy of the Rules governing the preparation of the separate records to show the results of operation of the Terre Haute Lines."

One of the trustees in bankruptcy, who at that time was also President of the debtor, testified as follows:

"Q. Mr. Scandrett, I understood from Mr. Swaine's remark made at the closing of the last hearing preceding this adjourned hearing, that it was the general opinion of Mr. Sparrow—I believe it was Mr. Sparrow, that there had not yet been made sufficient surveys which would reflect an accurate allocation of the revenues as between the lines west and the lines east. Do you subscribe to that opinion?

"A. Well, I do not subscribe and I do not differ with it. I think that there was made under Mr. Sparrow's direction, and it was testified to by Mr. Sparrow, a study on a formula which was the basis that he and his associate officers devised, and that study, by the use of that formula, showed certain results.

"Now, I do not know that it is for us to say whether that is adequate or inadequate. *It is the best that we could do.*

"Q. Within the time at your disposal?

"A. Well, I do not think the question of time was very important there. *I think we had lots of time; in other words, we devised the best formula that we knew how, or that we could work out, and the study was made on that basis.*"[1] (R. 1039-1040)

[1] All talics in this brief have been added.

The second proposition is that the Commission's action is vulnerable because of an alleged failure to determine whether the so-called "pieces of line east" were subject to the lien of the Fifty Year Five Per Cent. Mortgage, as the debtor had treated them in its exhibits and segregated earnings studies, or whether they became subject to a prior lien of the General Mortgage by virtue of its after acquired property clause. This matter is discussed at another part of this reply brief. (pp. 38-44) Suffice it to say here that the Commission in its plan proceeded on the basis of the debtor's own studies which treated these "pieces of line east" as subject to the lien of the Fifty Year Five Per Cent. Mortgage.

As its third point, debtor argues that the Commission erred in respect to interest on the Convertible Adjustment Mortgage. Its criticism is based upon an utter misconception of what the Commission did. The Commission's plan allocated to the Convertible Adjustment bondholders 1,749,492 shares of new common stock. (R. 1317) This stock if stated at $100 a share would amount to $174,949,200. The principal alone of outstanding Convertible Adjustment bonds was $182,873,693. (R. 1317) The Commission, therefore, did not make the allowance of interest as the debtor contends.

The Commission's only consideration in its plan to interest on the Convertible Adjustment bonds was in respect to the right of such bondholders to participate for the uncompensated portion of their claim with other unsecured creditors in the free assets of the debtor. As to such uncompensated portion the Commission correctly restricted its consideration to the accumulated interest which had already accrued and was unpaid at the date of bankruptcy. *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, 412 (1938). The Commission said:

"Thus there will remain 1,749,492 shares for dis-

tribution to the adjustment-mortgage bondholders for their claim upon the mortgaged assets of the debtor. Since the principal of this claim and interest to June 29, 1935, the date of filing of the petition, amount to $230,420,853, it is evident that the above allotment of stock, taken at $100 a share, will fail to satisfy the claim by $55,471,653. For this portion of their claim, these bondholders should be permitted to participate with other unsecured creditors in the free assets of the debtor. In view of the insufficiency of proceeds of mortgaged assets to meet the claims of the adjustment bondholders and the apparent inadequacy of the free assets to satisfy the deficiency, with interest, and the claims of unsecured creditors, with interest, we find that no allowance should be made in the plan for interest on these obligations for the period subsequent to the date of filing of the petition." (R. 2256-2257)

The remaining criticisms are of the Commission's illustrative examples of the failure of the property to provide earnings adequate for the old debt. They have nothing whatever to do with the integrity of the plan.

C. Brief of Preferred Stock Committee.

This brief reiterates the arguments already considered by the Commission, the District Court and the Circuit Court of Appeals, and decided by each of them adversely to the contentions of the stock interests.

The Commission's report shows on its face that it considered all elements of value, including earning power, in prescribing the permissible total capitalization for the reorganized company and in excluding the old stockholders from participation therein. (R. 2164, 2218, 2259, 2260) The Commission's report also shows that it rejected a capitalization based upon peak earnings of one or two years. (R. 2259)

The stock interests, while not petitioners here, inasmuch as their petitions for certiorari have not been granted, attack not only the decisions of the Commission and the District Court, but also the Circuit Court of Appeals, which sustained their exclusion from the reorganized company. Aside from their basic proposition that capitalization of the reorganized company should reflect physical value and minimize or disregard the earnings experience, past, present and prospective, of the enterprise, they rely on an alleged deficiency of findings and on the contention that the effective date of a plan of reorganization must, as a matter of law, be the date when the petition in bankruptcy was filed. This contention was overruled by the District Court. (R. 1871-1872) The Court held that the determination of the effective date of the plan was within the jurisdiction of the Commission, and also pointed out that pre-dating the plan, as sought by the stock interests, would result in taking away from creditors their right to have accrued and unpaid interest during bankruptcy treated the same as the principal of their debt in the distribution of new securities. The right of creditors to participate in the distribution of assets for both principal and unpaid interest on debt before anything can be returned to the bankrupt has long been recognized. *Coder* v. *Arts*, 213 U. S. 223 (1909). The same right applies in respect to the distribution of securities of a reorganized company. *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, at 527 (1941),[1] citing *Northern*

[1] In the *Consolidated Rock Products* case the petition for reorganization under Section 77B was filed on May 24, 1935. (114 F. (2d) 102, 104, affirmed in 312 U. S. 510) The accrued and unpaid interest, which this Court held was "entitled to the same priority as the principal" (312 U. S. at 527) was stated to be "As of April 1, 1937, the effective date of the plan." (312 U. S. at 514, footnote 4) Subsection (o) of Section 77B which was involved in that case contained exactly the same provision as subsection (1) of Section 77. (48 Stat. at L. 911, Ch. 424, Subsection (o))

Pacific Ry. v. Boyd, 228 U. S. 482 (1912); *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 (1939); *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U. S. 261, 266-267 (1914); *Ticonic National Bank* v. *Sprague*, 303 U. S. 406 (1938).

II.

BRIEFS OF CREDITOR INTERESTS.

A. The Briefs of the Generals and the Fifty Year 5s.

We desire to comment upon the respective positions of the Generals and the Fifty Year 5s[1] in their relation to each other before discussing separately certain of the contentions argued on behalf of those creditors.

The record contains extensive studies prepared by the staff of the bankruptcy trustees showing the revenues and expenses for test periods, together with a great deal of valuation and statistical data in exhibit form for the lines subject respectively, to the General Mortgage and the Fifty Year 5s. (See No. 5 of Appendix A to this brief; also R. 1308, 2247, 2250) In addition to the statistical exhibits and studies to which reference has been made, there was extensive testimony by a number of the accounting and valuation officers of the bankruptcy trustees, the Chairman of the Group of Institutional Investors, who is an engineer, and two experts in the field of railroad economics, operation and accounting called by the Fifty Year 5s.

The conflicting testimony thus presented on the relative values and contribution to the system of the lines east (the Generals) and west (the Fifty Year 5s) brought into this proceeding a controversy which has waged on this property through all the years since the construction of the lines west of Mobridge, South Dakota.

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[1] The trustee of the mortgage and certain holders of General Mortgage bonds are referred to herein as the "Generals" and the trustees and certain holders of the Fifty Year Five Per Cent. Mortgage bonds as the "Fifty Year 5s" or the "5s".

On the one hand it is contended that the General Mortgage lines constitute the heart of the system, that they contribute practically all of the earnings realized by the property, that the Milwaukee was a prosperous road until the construction of the lines west, that those lines are constantly operated at a deficit and are a useless appendage which should never have been built.

The opposing position of the Fifty Year 5s is summarized by the Commission in part as follows:

> "The bondholders' witness testified that the analysis of earnings for the western lines should be made for two full years, following methods other than those used by the debtor, among which changes would be the allowance of preferential divisions of 10 percent to the originating line in addition to the mileage prorate of revenue. He directed specific criticisms to alleged errors of calculation by the debtor, its charges for repairs to freight cars, terminal expenses, and the payment for use of equipment. His studies led him to the conclusion that the first and refunding mortgage lines contributed $6,249,099 of gross revenues and $3,300,400 of net revenues to the general mortgage lines in 1936; that the income for the 50-year mortgage lines, after payment of interest on the bonds of the Terre Haute, the Northern, the Gary, and the first and refunding mortgage lines, including the 'pieces of lines east,' was approximately $2,000,000, while the income of the general mortgage lines available for interest was approximately $6,400,000, after interest on equipment-trust certificates." (R. 2253-2254)

The Fifty Year 5s contend that their position has a much broader base than is recognized in this statement. They insist that the construction and operation of the transcontinental line west of Mobridge has met the compelling competitive necessity which caused its construction. Prior to the extension, the Milwaukee's operations were confined strictly to the so-called Western Trunk Line Territory. All of the major Western Trunk Line roads have recently experienced bankruptcy with the single exception of the

Burlington which is owned by the two "Northerns" and thus, in effect, is a transcontinental line. It is insisted, therefore, that any true appraisal of the worth of the lines west to the system, must take account of their contribution as a feeder and originator of system traffic. Objection is made to the use of any formula for this purpose on the ground that it "can give absolutely no value to the really important contribution" of the lines west, which is to give the system a direct outlet to the coast, thus securing and holding large quantities of traffic. It is pointed out that for the three and one-half year period, July 1, 1935 to December 31, 1938 "the total revenue * * * accruing to the Lines East and to the Lines West on traffic originating on the Lines West was $40,282,185 as against total revenue accruing to both Lines East and Lines West on traffic originating on the Lines East of $15,869,933." (Ex. 134)

These opposing contentions make up the ancient controversy which the Commission was called upon finally to resolve, as best it could, by a specific allocation of securities under a system mortgage. Of course, there is no formula or slide-rule method by which the value of each of these lines which are operated together as a single unified system can be determined with mathematical accuracy. Each of the opposing respondents argue that the true value of their respective lines should be ascertained by so-called severance studies, but it is utterly impossible to know what either line could earn now and in the future, if the other were not in existence, or were operated separately, because it is impossible to measure the effect of either assumption upon many competitive factors of infinite variety and complexity and upon the existing, long established traffic alignments which are vital.

The Commission made every effort to probe and to measure these imponderables. With voluminous earning studies

already before it the Commission called upon the Trustees in Bankruptcy (on May 4, 1937) to furnish earning data for the lines west on the theory of separate operation. The trustees with no interest in the proceeding save a desire to see the property reorganized on a sound basis, advised that they were unable to furnish such a showing—

> "* * * because no accounts are kept on the basis of separate operation, and separate operation involves *so many hypotheses that are wholly problematical that it is quite impossible to supply precisely that request;* but, we have prepared information which I take it will serve the purpose of the Director, that is, the allocation of the actual earnings of the property, as they are presently operated, assuming their continued operation as a part of the St. Paul System; * * * (R. 574-5)

Both the Generals and the Fifty Year 5s were in attendance at that hearing. Neither interest undertook to question the view of the Trustees that studies based upon the theory of separate operation of the lines east, and west, "involves so many hypotheses that are wholly problematical that it is quite impossible to supply precisely that request." Everyone knew then and knows now, the truth of that statement in respect to the debtor's system. In a severance study for a small branch or segment of line the probable error may be held within narrow limits, but to assume separate operation of the Western Trunk Line and the transcontinental lines of this system after many years of unified operation, and to seek to imagine what traffic alliances would be made by the severed portions and with what result, is to enter the domain of fancy and speculation. It is because of the existence of these very factors

that any effort to resolve this old controversy by assignment of precise dollar valuations would be the merest pretense.

In compliance with the Commission's request for all possible light on this problem H. A. Scandrett, one of the trustees of the property, offered the showing referred to in the statement quoted above. On all of the evidence thus made available to the Commission the question called for the exercise of its informed judgment. The law does not require the impossible. This Court has just said:

> "Since its application [the criterion of earning capacity] requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth." (*Consolidated Rock Products Company* v. *DuBois*, 312 U. S. 510, 526)

The allocation of securities between the Generals and the Fifty Year 5s which the plan provides, represents the effort of the Commission after full hearing and all the evidence it could secure, to discharge that duty.

Except for the final hearing in the proceeding, which was before the entire Commission, the hearings were conducted and the evidence heard by a Commissioner, the Director of the Bureau of Finance, and an Examiner. Upon the record so made, all parties filed briefs, and the Examiner then issued a proposed report recommending for the consideration of the Commission a plan of reorganization. In the Examiner's recommended plan the allocation of securities to the Generals and the Fifty Year 5s was as follows (R. 1239):

	Total Claim (Principal and Interest to 1/1/39)	First Mtge. 3½% bonds	General Mortgage 4½% Bonds		5% Pref. Stock	Comm Stock n.p.v. Shar
			Series A	Series B Conv.		
Generals	$156,368,193	30%	30%	20%	20%	
50-Yr. 5s	127,230,802		10%	10%	60%	30

Exceptions to the Examiner's report and supporting briefs were filed and the case submitted upon oral argument to the Commission. By its report the Commission modified the treatment proposed by the Examiner and accorded the Generals somewhat more favorable treatment in relation to the Fifty Year 5s than the Examiner had recommended. (R. 1317, 2269) The allocation to these two issues in the approved plan is as follows:

	First Mtge. 4% Bonds	General Mortgage 4½% Bonds		5% Pref. Stock	Com. Stock No. Par Value Shares
		Series A	Series B Conv.		
Gen. Mtge. Bonds	25%	35%	20%	20%	
50 Yr. 5s			15%	60%	25%

Here, in definitive form, the Commission has expressed a conclusion on conflicting and highly technical evidence respecting a problem which presents many imponderables. The Generals and the Fifty Year 5s, both seek to defeat the plan, but their methods of obtaining that result are different.

In the extended hearing before the Commission the trustee of the Generals did not offer a witness or a word of testimony in respect to the basic question which they now argue—the relative earnings and value of the lines east versus the lines west.[1] They not only offered no evidence on the subject, but neither before the Commission, in the courts below, nor here, have they attempted any analysis of the earning data on which the Commission acted. Instead, their briefs consist largely of the iteration and reiteration of a statement by the Commission which by removal from its context they grossly distort. The Com-

[1] The sole contribution of the Generals to the record before the Commission was the brief testimony of a member of the staff of the Trustees of the property, called at one of the last hearings before the Commission, on March 21, 1938, showing the earnings of the "pieces of lines east" to be $170,000 in 1936. (R. 1129)

mission, in discussing the argument of the Fifty Year 5s that the true value of the western lines lay in their *separate* operation," (R. 1307) stated:

> "We are satisfied that on any reasonable basis of allocation between the lines west and the other parts of the system, the lines west cannot be expected to earn any sum for the payment of interest."

The immediately succeeding sentence in the Commission's report is as follows:

> "In years when the system earnings approach $10,000,000, some interest is apparently earned for the 50-year mortgage bonds under the present capital structure, but this reflects *system* operation and does not demonstrate any earning power for the western lines."

It is clear that what the Commission is saying in response to the argument of the Fifty Year 5s, is that the earnings of these lines flow from their operation as an integral unit of the system. The Commission's statement thus relied upon by the Generals does not lend itself, therefore, to the use that they seek to make of it. In its initial report dealing with the same point the Commission had already said:

> "If the holders of the 50-year bonds are assigned a part of the new series B income bonds only, as herein provided, they will begin to share earnings with the general mortgage bonds and Northern consolidated bonds after $9,675,000 of prior charges, including a payment of $2,500,000 to the additions and betterments fund, such charges reflecting the respective amounts of equipment obligations, etc., upon which this approved plan is based. We think that this treatment goes far toward resolving the doubts as to the accuracy or fairness of the allocation of earnings in favor of the 50-year bonds, without injustice to the general mortgage bonds." (R. 2254-2255)

The Reliance of the Generals and the Fifty Year 5s Upon the Present Level of Earnings.

The Generals find no embarrassment in arguing that the Commission should now be required to give consideration to recent earnings, and in the light of such earnings, to

redetermine the permitted fixed charges of the reorganized company, and arguing in the same brief that those earnings must not be considered by the Commission for the purpose of any redetermination of the treatment to be accorded the Fifty Year 5s as a result of the recent marked increase, both absolute and relative, in the earnings of the lines west.

Arguing that recent earnings should be taken into account in determining the fixed charges the General Mortgage trustee states (p. 36) that:

> "The court cannot shut its eyes to the fact that the plan is based on earnings ending with 1936. Since that time the earnings have so greatly increased that the court has ordered payment out of the road's earnings of nearly twenty million dollars of accrued interest on these bonds."[1]

But elsewhere in its brief, the Generals desire to meet the argument which they rightly anticipated would be made on behalf of the Fifty Year 5s that those creditors should receive some consideration from the fact that the earnings of the lines west had recently very greatly increased.[2] To off-set this, General Mortgage trustee quotes with approval the recent decision of the Circuit Court of Appeals in the *Chicago and North Western* case (126 F. (2d) 351, 364) stating that the recent war earnings of the railroad are "temporary" and "not to be taken too seriously when viewing the long future of this railroad."

In short, it appears that the Generals believe that the present "temporary" earnings which are "not to be taken too seriously when viewing the long future of this railroad" may properly be taken into account in the ascer-

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[1] The total interest on debt accrued and *unpaid* is now approximately one hundred and seventy-two million dollars. (See p. 8 of this brief)

[2] "Since the period considered by the Commission, the earnings of the western lines have greatly improved. At the moment they are we believe highly remunerative." (Brief of General Mortgage Trustee, page 44)

tainment of permissible fixed charges, but should not be taken into account in the treatment of the Fifty Year 5s *vis-à-vis* the Generals.

We submit (1) that war earnings should not be the basis either for determination of fixed charges as the Generals contend, or (2) for determination of the proper treatment of the Fifty Year 5s as counsel for those holders contend.

(1) Section 77(b) provides that the plan of reorganization;

> "* * * (4) shall provide for fixed charges (including fixed charges on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof * * *;"

In the determination of the amount which it could safely commit this twice bankrupt railroad to pay, as a fixed charge, in every year, bad and good alike, the Commission of necessity gave consideration to the minimum basis of earnings which the property might fairly be expected to experience, and in doing so took account of the earning record of the carrier during the period through which it had just passed. Section 77(b) specifically directs the Commission to determine fixed charges for the debtor "in light of its earning experience" with the result that there shall be adequate coverage of such fixed charges. Nothing would be more certain to bring yet another reorganization of this property than to determine fixed charges on the basis of boom earnings such as those experienced in 1929 immediately preceding the depression, or those being experienced for different reasons at this time.

An analysis of the briefs shows that more of the objec-

tions to the plan[1] stem directly or indirectly from the complaint against the measure of the fixed charges than from any other provision of the plan. This fact throws light on the attenuated nature of the attack because the limitation upon the total annual fixed charge will not, of course, affect the amount of income available for interest, and will not operate to reduce the income actually disbursed to creditors over a period of years. It may well increase it. The basic purpose of holding the fixed charges to a conservative basis which the property can reasonably sustain is to avoid another reorganization and so to conserve the income of the enterprise for its creditors. In actual practice, the level of the fixed charge will not control the amount paid as interest in any year, except it be a year of such low earnings, and the cash position of the company be so adverse, that in the exercise of a wise discretion the management would not make a payment as large as the fixed charge if it were not compelled to do so to avoid default and bankruptcy. All this is necessarily so because, under the plan, the entire earnings of the property go to the creditors, and it is self-evident that the income which they do not receive as a fixed charge they receive in another form, as interest on income bonds, or as dividends.

On the other hand, the vital question as to the ability of the reorganized company to avoid another default and keep out of bankruptcy is determined by the level of its annual fixed obligations in relation to its earning capacity. The decisive question is one of fact.

We believe that nothing would constitute a greater disservice to the creditors of this road than to ascribe any weight to present earnings in the determination of permissible fixed charges. It would be equally erroneous, we

[1] Particularly those of the Generals and the Terre Haute. Since the Fifty Year 5s are not allotted any new securities bearing fixed interest, or indeed any of the new Series A income bonds, the permissible fixed charge level cannot directly affect their treatment.

believe, to take account of those earnings in a consideration of the respective priorities of the Generals and of the Fifty Year 5s, as counsel for the latter now contend.

(2) The Fifty Year 5s direct attention (their brief, page 41) to exhibits presented in the District Court on April 14th of this year in connection with the petition of the trustees of the debtor's estate to make a payment of interest. Those exhibits showed the segregated earnings of the several mortgage divisions for the three-year period January 1, 1939 to December 31, 1941. The 5s' brief correctly states that:

> "This exhibit was prepared on the same basis as those previously introduced before the Commission, except that (as in the case of the years subsequent to 1936 shown in Court Exhibit 34) it was based on actual ascertainment from waybills for every month." (p. 42)

The exhibit to which the Fifty Year 5s refer shows for the year 1941, a higher level of income for the lines west than in earlier years, both in dollars, and in relation to the earnings, during the same period, for the General Mortgage lines. Although, as stated, the allocation of earnings between the several mortgage lines in these exhibits was made on the same basis as the earlier studies of record, which the Fifty Year 5s assert to be wholly inadequate and inconclusive, they state that the later studies "demonstrate clearly a greater relative worth for the Fifty Year 5s than the Commission's plan recognizes." (page 41). It appears that the test which the Fifty Year 5s apply in measuring the adequacy of a study is not its intrinsic worth, but the result which it produces for the lines west.

The second comment which should be made on the reliance of the Fifty Year 5s upon the recent showing in the District Court, is that they have failed to call attention to the testimony of the witness who prepared and introduced these exhibits. The studies were prepared and introduced by the chief financial and accounting officer of the trustees in bankruptcy. He testified that for fifteen years he had

had supervision over the preparation of all freight commodities statistics, that he had had occasion to observe the pattern and the flow of traffic over the various constituent lines of the system during that period, and that in his opinion the volume of traffic carried over the lines west for the year 1941 could not be considered as normal in relation to that carried by the other constituent lines of the system. (Transcript of hearing April 14, 1942 in the District Court, p. 45) The reason for this, the witness testified, is that much of the transcontinental traffic which moves to and from the Pacific Coast over the western lines, is in competition with the movement of traffic through the Canal, and that the complete withdrawal of ships furnishing intercoastal service through the Canal due to the war, caused the increase in traffic, and the relatively greater increase in traffic, over the lines west. (Tr. pp. 62-63) At the same hearing Trustee Scandrett testified that, in addition to the elimination of traffic through the Panama Canal, traffic over the lines west had been greatly increased by the activity at the large Naval Yard at Bremerton in Puget Sound and the large cantonments and other war enterprises in the Pacific Northwest. (Tr. p. 76)

It will be seen that the exhibits referred to by the 5s, were they in the record, would afford no support to their attack upon the allocation of securities provided by the plan.

The Attack of the Fifty Year 5s Upon the Adequacy of the Record.

The text of the main argument of the Fifty Year 5s is that the record made during the period of five years that this proceeding was pending before the Interstate Commerce Commission does not contain adequate factual data as a basis for the allocation of securities. It is strange, we suggest, that these parties, represented by two sets of counsel at the hearings before the Commission, should feel that they are in a position to make such an argument. The record shows that the Commission was constantly

seeking all possible light from every source on the complex questions before it, and if these parties and their counsel did not participate in the proceeding for the very purpose of avoiding the condition of which they now complain, it is difficult to understand what their function in the proceeding could have been. (See especially the statement of Director Sweet of the Commission's Bureau of Finance at the conclusion of the first set of hearings on August 7, 1935. R. 539) Certainly it is not their function to remain dormant while the record is made up, and then to delay and defeat the reorganization process by asserting that they withheld from the Commission the evidence necessary to a proper determination of the issues.

Beginning on page 29 of their brief these respondents seek to reconcile their participation in all the long hearings before the Commission, with their charge that the record so laboriously made is wholly inadequate. Much point is made of the fact that during the early stage of the proceedings, the hearings were on the debtor's plan which, they emphasize, "did not propose a disruption of major liens." (p. 30) If all of this discussion is intended to show that the Fifty Year 5s were lulled into a false security by the terms of the debtor's plan and did not appreciate, as the statute contemplates (Section 77(b)), that their rights as creditors would be modified, it should be pointed out that the debtor's plan, Exhibit 1, filed with the Commission July 1, 1935, placed the entire interest of the Fifty Year 5s subordinate to the entire interest on the Generals, a treatment less favorable than the 5s receive in the certified plan. The evidence is conclusive that the 5s had a full and fair hearing before the Interstate Commerce Commission.

Actually, the impression created by the brief of the Fifty Year 5s in this Court that they made no contribution to the record in this case and that they did not take advantage of their opportunity to present a case, does them a serious injustice. They did in fact offer voluminous evidence through two well known railroad experts, with long experience in the analysis of railroad operation and statistics.

(R. 990-1018, 1090-1128) The testimony of these witnesses was analyzed and discussed by the Commission in its reports. (R. 1307-8, 2252-4) The true situation, therefore, as those reports show, is that the Fifty Year 5s did take full and effective advantage of their opportunity to offer evidence, and that the conclusions of the Commission were based in part on the showing thus made.

In view of their contention here that the record is inadequate and that the proceeding should be sent back to the Commission for another tortuous unwinding of the administrative process, we think the Court should know that these respondents are simply continuing their effort to postpone and delay this reorganization, an effort which began in the hearings before the Commission. Their briefs before the Commission began with the statement that it was futile to discuss reorganization of the property at that time and ended with the request that the proceeding be discontinued. They appear to be still of the same purpose.

In conclusion, we submit that the Fifty Year 5s' own discussion (see their brief, page 28, *et seq.*) of the voluminous earnings data of record in their brief in this Court shows how painstaking was the factual investigation of the Commission. It shows, too, that the highly technical factual issues respecting the allocation of the securities are of a nature peculiarly within the competence and the experience of the Commission to decide.

The Provision for a System Mortgage Is Within the Power of the Commission.

Both the Generals and the Fifty Year 5s attack the provision in the plan that there shall be a single system mortgage embracing both the lines east and the lines west. We desire to make two comments on this objection.

1. The contention that the liens of the Generals and the Fifty Year 5s be left undisturbed, and that some means

be found to that end, either by the separate incorporation of the properties or otherwise, was fully argued to the Commission and ruled upon by it, as follows:

> "We see no means by which the exact present lien position of the general mortgage bonds or the 50-year bonds can be preserved except under a prohibitive mortgage structure." (R. 2255)
>
> "The question of the formation of a separate corporation for the Milwaukee's western lines or of the separation of the western lines from the rest of the system by a separate mortgage has been considered by us heretofore in connection with the plan and we are of the opinion that there would result no advantage therefrom to the present holders of the 50-year mortgage bonds and the general mortgage bonds, respectively. It seems to us of great importance that a completely unified system be created through the reorganization and that the capital structure be not complicated by numerous mortgages." (R. 1307)

In overruling the contention for divisional mortgages, the District Court stated in its memorandum opinion that:

> "The advantage resulting from the elimination of divisional mortgages is obvious. In fact, many of the difficulties arising in current reorganization proceedings are attributable in large measure to the existence of many mortgages on parts of a system. The desire of the Commission to eliminate that objection is commendable." (R. 1888)

There is no basis in the statute for the contention that the Commission must make a plan which will preserve as inviolate, all the features and complexities of the old capital structure. On the contrary, Section 77 specifically provides:

> "(b) * * * a plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * *"

The *Consolidated Rock Products* case is decisive against the contention. The Court there stated:

> "The Circuit Court of Appeals, however, made certain statements which if taken literally do not comport with the requirements of the absolute priority rule. It apparently ruled that a class of claimants with a lien on specific properties must receive full compensation out of those properties, and that a plan of reorganization is *per se* unfair and inequitable if it substitutes for several old bond issues, separately secured, new securities constituting an interest in all of the properties. That does not follow from *Case* v. *Los Angeles Lumber Products Co., supra.* If the creditors are adequately compensated for the loss of their prior claims; it is not material out of what assets they are paid. So long as they receive full compensatory treatment and so long as each group shares in the securities of the whole enterprise on an equitable basis, the requirements of 'fair and equitable' are satisfied.
>
> "Any other standard might well place insuperable obstacles in the way of feasible plans of reorganization. Certainly where unified operations of separate properties are deemed advisable and essential, as they were in this case, the elimination of divisional mortgages may be necessary as well as wise. Moreover, the substitution of a simple, conservative capital structure for a highly complicated one may be a primary requirement of any reorganization plan. There is no necessity to construct the new capital structure on the framework of the old." (312 U. S. 510, 530-531)

Notwithstanding this clear statement, it is argued that the Commission did not have the power under the statute to simplify the capital structure of this property by creating a single mortgage and providing for the proper participation of all creditors in the securities under the new mortgage, and to so modify and alter the rights of creditors as might be necessary to that end. This contention cannot stand against the terms of the statute and the recent decision of this Court.

2. It is to be noted also that any impression that the

troublesome problem of allocating earnings between the respective liens of the Generals and the Fifty Year 5s could be avoided or mitigated by the creation of separate corporations and the continuance of the existing liens, is an illusion. In order to ascertain what, if any, fixed interest securities should be issued under the two mortgages, the Commission would be obliged to make exactly the same determination of relative values and earnings which it was necessary to make under the approved plan, and to do so by the same difficult process. But this would only be the beginning. Both of these interests recognize that for a substantial portion of their claims they must receive income bonds and stocks. A basis for dividing the system income for each year between the two constituent mortgage properties would become necessary. Clearly the allocation could not be determined wholly *de novo* each year. The plan, and pursuant to the plan, the mortgage indentures, would have to spell out some highly complicated basis or formula to govern the annual allocation of income between the two liens. Unless the basis for that allocation were clear and inflexible constant litigation would arise. If the basis were clear and inflexible, and based upon all of the relevant facts which could be adduced by all of the parties in interest, then the results would, of necessity, be precisely that produced by the basis of allocation provided by the approved plan. In short, whether the distribution be, in form, an allotment of the securities of one mortgage or of many mortgages, it is in essence an allotment of income, and the basis of that allotment must always be the relative value and earnings of the properties involved.

"Pieces of Lines East."

The Generals assert (Moses Brief, page 18) that "The Commission expressly declined to pass on the ques-

tion whether these 'pieces of lines east' are or are not subject to the General Mortgage." It is argued that the plan is defective on this ground.

The Commission did not "expressly decline" to pass on the question but, on the contrary, as the record shows, in the absence of competent evidence to the contrary, treated these "pieces of lines east" as subject to the lien of the Fifty Year 5's, as they had been treated in the lien and earnings studies of the debtor and the staff of the Trustees of the debtor.

The so-called "pieces of line east" consist of a number of short segments of track lying east of the Missouri river constructed long after the General Mortgage was executed. They are specifically enumerated and described in the First and Refunding Mortgage (Com. Exs. 24 and 25) and are subject to the first lien of that mortgage. They were so described by debtor's vice president in his testimony. (R. 293, 335) The lien studies prepared by the Trustees' staff likewise assigned these pieces of line to the first lien of the First and Refunding Mortgage and to the second lien of the Fifty Year Five Per Cent. Mortgage. (Com. Exs. 73, 75)

All of the various earnings studies prepared by the Trustees' staff assigned these pieces of line to the First and Refunding and Fifty Year Five Per Cent. Mortgages.[1] (For 1931, Com. Ex. 92; for 1930, Com. Ex. 93; for 1936, Com. Exs. 145, 146) So, likewise did the summaries for 1936 presented by the institutional group. (Com. Exs. 180, 181)

These are the several earnings studies which, adjusted in the light of the other relevant factors bearing on the

[1] The aggregate net earnings of these lines in 1936, which was the test year used in many of the earnings studies of record, were $170,000. (Ex. Com. 181)

value of the several mortgage divisions, constituted the basis of the Commission's allocation of securities. It was not until March 21, 1938, that the trustee of the General Mortgage asserted a claim to these pieces of line by virtue of the after-acquired property clause of that mortgage, as being "appurtenant" to the General Mortgage lines under that clause. (R. 1131) This was the day prior to the close of hearings before the Commission. (R. 1158) Objection was made by the trustees of the Fifty Year 5's to one of two exhibits (Com. Exs. 218, 219) offered in connection with this claim on the ground that it was incompetent and without proper foundation. (R. 1130-1138) The presiding Director of the Bureau of Finance ruled that "the question of whether the lien of the mortgage attaches to the after-acquired property listed is primarily a judicial question for determination by the courts." (R. 1151) He further ruled: "In view of the objections made, the Commission should not and cannot undertake to try the question at this time. The statement will be admitted as evidence of the fact that the mortgage trustee asserts the claim that the mortgage covers the lines listed, but cannot be admitted as evidence in support of that claim." (R. 1151)

No further evidence was offered in support of this asserted claim of the General Mortgage trustee, either before the Commission or the District Court, nor was the claim pressed by it then or thereafter. The Commission proceeded to consider the lien studies and earnings statements as they had been presented by the debtor and the Trustees' staff. In order not to prejudice the claim of the General Mortgage trustee, however, if it should seek a different judicial determination, the Commission in its report said:

> "The propriety of crediting the First and Refunding Mortgage, or the 50-year Mortgage with the earnings of the 'pieces of lines east' is rendered doubtful in the absence of a judicial determination of the ques-

tion whether these lines are subject to the first lien of the First and Refunding Mortgage or to that of the General Mortgage." (R. 2252)

The trustee of the General Mortgage did not take any further action to assert the claim. The trustee merely stated before the Commission "that, *if* the 'pieces of lines east' should be *found by the court* to be subject to the first lien of this mortgage [General Mortgage], a more favorable treatment should be accorded." (R. 2209) Yet the trustee abandoned any effort to secure a determination by the court, as hereinafter noted, and explained its inaction by advising the Commission on brief that the earnings of these lines "are relatively inconsequential."

On the basis of that record, a few General Mortgage bondholders who now complain but who made no appearance of any sort in the long proceedings before the Commission, objected at the hearing on the plan in the District Court to the Commission's assignment of these lines to the Fifty Year 5s, and requested the Court to make a different determination. (Objections to the plan of certain holders of General Mortgage bonds, R. 1424) After full hearing and argument the District Court refused to disturb the action of the Commission and approved the plan. That, we submit, disposed of the claim. Respondents' petition for certiorari which sought to raise the issue here has not been granted.

This, however, is not the full story on this point. In its brief, filed after the close of the record before the Commission, the trustee of the General Mortgage stated:

> "Both plans have been prepared upon the assumption that its [General Mortgage's] lien did not cover certain lines of railroad of comparatively small extent which were constructed or acquired by the Railroad Company after the execution of that mortgage. Application is about to be made to the District Court for a determination in respect to the lien of the General Mortgage on such lines of railroad, which have been generally referred to as 'pieces of lines east,'

some of the parties questioning our contention that these pieces of lines are subject to the lien of the General Mortgage. *These pieces of lines are but a minor component of the Debtor's whole system and their earnings are relatively inconsequential*, but if the contention of the trustee of the general mortgage should be sustained it would warrant somewhat better treatment of the General Mortgage bondholders than is provided in the plans." (pp. 2-3 of brief dated May 31, 1938)

The application which was then "about to be made to the District Court" was the subject of discussion between counsel for the General Mortgage trustee, the then counsel for the debtor, and counsel for the Fifty Year 5s. Consideration was given to a joint application to the District Court for judicial determination of the lien question by those interests. But the proposed application to the Court was deliberately abandoned, and for good reason. The plan promulgated by the Commission, like that of the Group's, provided for a system lien. Under such a plan, a determination of the lien issue in respect to the "pieces of lines east" could be material only if the earnings of those pieces of line would affect the allocation of securities between the Generals and the Fifty Year 5s. Because, as the General Mortgage trustee stated (*supra*), "their earnings are relatively inconsequential," it was decided that litigation of the highly complicated issue which would thus be raised was not warranted. The problem of determining the relative values of the Generals and the Fifty Year 5s as a basis for the allocation of the new system mortgage securities, is not susceptible of such precise treatment and solution as to require any such refinement. It is for this reason, understood and tacitly accepted by all interested parties, that the proposed court application was not made. To say now that it was necessary to the protection of the rights of the Generals or the Fifty Year 5s, is to say that in abandoning the application the trustees of

those mortgages and other parties in interest were derelict in their duties. Those mortgage trustees are careful to avoid any direct assertion that the determination of the question was necessary to the formulation of a fair and equitable plan. The Groups are convinced that the mortgage trustees did not fail in their duty in this regard. In view of the actualities the issue is essentially an academic one, and one that would have involved a needless expense to this estate and to the parties.

The consideration of the various interested parties of the institution of a proceeding for the determination of this question by joint application to the District Court, and their decision not to enter upon that litigation constituted in substance a settlement of the question. In *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 130 (1939) the Court said:

> "There frequently will be situations involving conflicting claims to specific assets which may, in the discretion of the court, be more wisely settled by compromise rather than by litigation. Thus, ambiguities in the wording of two indentures may make plausible the claim of one class of creditors to an exclusive or prior right to certain assets as against the other class in spite of the fact that the latter's claim flows from a first mortgage. Close questions of interpretations of after-acquired property clauses in mortgages, preferences in stock certificates, divisional mortgages and the like will give rise to honest doubts as to which security holders have first claim to certain assets. Settlement of such conflicting claims in the *res* in the possession of the court is a normal part of the process of reorganization. In sanctioning such settlements the court is not bowing to nuisance claims; it is administering the proceedings in an economical and practical manner."

In their search of the record for technical objections to the approved plan these respondents now contend that the making of a plan for this property should be held up

pending further litigation over this question. Respondents took no part in the proceedings before the Commission during the period of almost five years they were pending there. Nevertheless they had their day in the District Court on this issue. We believe, moreover, that a party entering one of these complicated reorganization proceedings at the eleventh hour should not be permitted to raise questions which were in effect settled by the interested parties in an earlier stage of the proceeding.

Attack on Additions and Betterments Fund.

The attack of the Generals on the provision for an Additions and Betterments Fund is based on the contention that the Fund constitutes a diversion of "income". (Brief of General Mortgage Trustee, pp. 59-60; Moses Brief, p. 24) Such an argument ignores the fact that the real income is that, and only that, which remains after the unavoidable operating costs have been paid. In essence the attack is on the maintenance of depreciation accounting which the Interstate Commerce Commission has been requiring in respect to certain classes of railroad property since 1907. In that year, long before the Commission had its present plenary authority over the accounts of interstate railroads, it required depreciation accounting for equipment on interstate steam railways. (Depreciation Charges of Steam Railroad Companies, 177 I. C. C. 351, 360) The Commission's order requiring depreciation accounting for roadways and structures generally will become effective January 1, 1943. The plan provides that if the reorganized company shall establish and maintain an operating expense account for roadways and structures, then the Additions and Betterments Fund shall be paid from the reserve for depreciation on roadways and structures and the Additions and Betterments Fund credited in respect of such payments. (R. 1271, 1982-3) The Trustees of the debtor's property state that "While it is impossible

at this time to predict with certainty the effect of applying depreciation accounting to this class of property, it is quite probable that the amount of depreciation upon such property may be sufficient to take care of the mandatory requirement for additions and betterments under the plan." (Bankruptcy Trustees' Brief, p. 15) The fact that the amounts complained of will be charged as depreciation shows the reality which has always existed, namely, that the actual income is that, and only that which remains after payment of the unavoidable operating costs which the Additions and Betterments Fund is set up to meet.

The thorough consideration of this subject by the Commission as discussed on pages 64 to 68 of our original brief answers the argument that the Additions and Betterments Fund is unnecessary.

We quote as follows from the brief of the Trustee of the General Mortgage:

> "The Commission has recently (June 8, 1942) issued an order making it mandatory to set up depreciation on roadway and structures, effective January 1, 1943. It is likely that for the future this will render the question of the legality of such mandatory additions and betterments funds as was proposed by the Plan largely academic. * * * Additions and betterments will have been paid for from income, and the amount available for mortgage interest will have been thereby decreased. But it will have been done legally, because depreciation is a charge properly made at the expense of income." (pp. 59-60)

In the light of this conclusion it is not clear why the Generals have again argued their objections to the provision for the Additions and Betterments Fund.

B. The Terre Haute Lease.

The crux of the objection of the Terre Haute bondholders is that the plan does not provide that the entire annual interest on their bonds, amounting to $1,023,580, shall be paid as a fixed charge out of the total authorized fixed

charges of the entire system of $4,269,654. Under the offer which the plan tenders to the Terre Haute bondholders they would receive 70% of their interest as a fixed charge. The remaining 30% would be contingent upon earnings and fully paid out in any year in which system earnings amount to $9,675,139.

The General Mortgage bondholders, on the other hand, insist that the treatment which the plan offers to the Terre Haute is too favorable to those claimants and would operate improperly to reduce the fixed interest bonds available for the Generals.

It is evident that the property cannot pay the interest on the claims of all its senior creditors out of an annual fixed charge of $4,269,654, so that this is essentially a contest between opposing classes for payment in a type of security which cannot be issued in an amount sufficient to satisfy the claims of all. In support of their demand for a larger portion of the fixed interest obligations, the Generals content themselves with the pronouncement that the Terre Haute lease should be cancelled, and that the use of the Terre Haute properties be obtained by means of an operating agreement "for an adequate consideration."

By a variety of technical arguments the Terre Haute bondholders seek to insulate themselves from the effects of the inexorable economic factors which have forced a reduction in the fixed charges of this property from $20,000,000, as they stood at the time the lease was made in 1921, to $4,269,654, the basis which the Commission now finds to be the maximum which it can safely commit the property to pay as a fixed charge in good years and bad.

It should be noted at the outset how favorable to the Terre Haute is the provision that it may, if it accepts the offer, receive 70% of its interest as a fixed charge even when the annual earnings of the entire system are only

$4,269,654, and how extreme is its claim that its entire interest be made a fixed charge of the reorganized company. Of the total authorized fixed charges for the system in the amount of $4,269,654, approximately $1,286,000 must go to meet the requirements on the equipment necessary to operate the system, including the Terre Haute. Another $500,000 goes to the Reconstruction Finance Corporation to service the loan made by that agency during the depth of the depression. This leaves approximately $2,500,000 available annually as fixed interest for all creditors having liens, both on the 10,000 mile Milwaukee system and the 300 mile Terre Haute property. What the Terre Haute bondholders are seeking, therefore, notwithstanding the tremendous reduction which has become necessary in the amount of the system's total fixed charges, is that they continue to receive as a fixed charge out of this $2,500,000, their full interest which is in excess of $1,000,000. They would thus receive approximately 69% of what would then remain for all system bonds, other than those allocated to the Reconstruction Finance Corporation. This is the demand of bondholders who have a lien on a bare 3% of the system mileage which is wholly dependent upon system earnings, and who received less than 5% of the system fixed charges when the lease was made. We shall examine now the arguments in support of the contention that the reorganization and the creditors of this large system of railroad are so completely at the mercy of the bondholders of this small leased line.

The Objection That the Offer Does Not Observe the Priorities.

The first of these objections is that the Commission's offer to the Terre Haute bondholders as an alternative to the rejection of the lease constitutes a reorganization of the Terre Haute, and that the reorganization which would thus be accomplished does not preserve the priorities of

the several classes of Terre Haute creditors.[1] A sufficient answer to this argument, we believe, is that the Terre Haute bondholders may decline the offer, it being specifically provided in the plan that it shall become effective only if accepted by substantially all of the Terre Haute bondholders. (R. 1331)

If, as these interests contend, the proposed modification of the lease will, in effect, accomplish a reorganization of the Terre Haute, it will be a reorganization only by their consent. The fundamental question is whether the Commission is to be sustained in providing in the plan for the rejection of the lease in the event that the Terre Haute does not agree that it shall be modified.

The Objection That the Commission Was Without Power to Reject the Lease Or to Do Otherwise Than to Provide For Its Unqualified Adoption.

The bald proposition which the Terre Haute seeks to sustain in this Court (as its Point IB, p. 14) is that the Commission was powerless to provide for the rejection of the Terre Haute lease or to qualify its adoption by the change of a letter in its text. It is flatly contended that on the record before it the Commission had no alternative but to saddle the new company forever, with a contract, improvident when made[2] and imposing obligations which in the light of the changed conditions now existing cannot be met, and in equity and fairness should not be met.

Section 77(b) provides that a plan of reorganization—

"may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; * * *."

In the exercise of this power the Commission provided in the plan for the rejection of the Terre Haute lease. To force the unqualified adoption of the lease and thus con-

[1] Point IA, page 8 of the Terre Haute Brief. It is stated that this argument is advanced on behalf of some of the Terre Haute interests and that others do not subscribe to it. (p. 3)

[2] "... the terms upon which the property was acquired were improvident and to that extent adversely affected the financial condition of the St. Paul." *Chicago, Milwaukee & St. Paul Investigation*, 131 I. C. C. 615, 657.

tinue to receive its full interest as a fixed charge, the Terre Haute argues that the Terre Haute lease is not burdensome and, therefore, may not be rejected by the Commission in the plan under Section 77(b) quoted above.[1]

In the courts below the Terre Haute did not contend that there was any inadequacy in the findings of the Commission respecting the treatment of the Terre Haute lease. Here, however, seeking to take advantage of the holding of the Circuit Court of Appeals, the Terre Haute contends that the Commission's report lacks adequate findings.[2]

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[1] In authorizing the Commission to reject leases under Section 77 the Congress was not conferring upon the Commission any essentially new power. By Section 5 of the Interstate Commerce Act as amended by the Transportation Act, 1920, the Commission was given complete control over leases by one railroad of the lines of another. In *Chicago, Milwaukee & St. Paul Investigation*, 131 I. C. C. 615 at 663, the Commission commented upon the public importance of this provision and the desirability, in the light of its experience with the Terre Haute, of not approving such leases *ex parte* and without full investigation. In view of the recognized desirability of Commission investigation and approval before such assumptions of liability, it would have been strange if Section 77 had not empowered the Commission to exercise the same jurisdiction in respect to railroads emerging from bankruptcy, the roads above all others which are most in need of such protection. Since 1920 the Commission has exercised its power to authorize or to refuse to authorize the making of leases, and the assumption of liability on securities in connection therewith, many hundreds of times. It is significant that in no instance in that long period has any court set aside a single order of the Commission authorizing or rejecting a proposed lease.

[2] It would seem that the Terre Haute could find scant comfort in the decision of the Circuit Court of Appeals in the course of which the Court said:

> "The value of these bonds and the circumstances under which the road was acquired, have given this transaction a malodorous reputation." (R. 2305)
>
> "A management with ethics which would tolerate the Terre Haute transaction was sure, sooner or later to be applying to a court of equity or court of bankruptcy for protection against the hordes of insistent claimants with past due unpaid obligations." (R. 2311)

It appears that if the Court had any doubts on this issue apart from its view as to the general deficiency of the Commission's report in respect to findings, its sole doubt was whether the lease should not be rejected with finality, and no offer made. (R. 2314)

The Commission found, on the evidence, as we shall show, that for four reasons this lease is so burdensome that its adoption would "jeopardize a successful reorganization of the Milwaukee" and that its rejection "is a necessary step in order that the processes of reorganization of the Milwaukee may not be thwarted." (R. 1303)

The Milwaukee is obligated under the lease to pay at maturity the principal of the Terre Haute bonds which aggregate approximately $22,000,000.[1] One of the serious burdens of the lease is the very early maturity of these bonds. The shortest maturity for the securities of the reorganized company as fixed by the Commission in the plan, is fifty years. The Commission's offer to the Terre Haute provides for an extension of its maturities to the maturity date of the First Mortgage bonds of the new company, which is fifty years after the effective date of the plan. (R. 6995-6996)

The second of the insupportable burdens of the Terre Haute lease is the covenant to replace equipment and the existing default in this covenant in the amount of some $8,000,000. As stated in the Terre Haute's brief "the debtor itself was in default on this (latter) obligation to the extent of approximately $5,000,000 when the reorganization proceeding was instituted on June 29, 1935, * * *". (Terre Haute Brief, p. 5) The burdensome nature of this covenant cannot be made a matter of debate in view of the fact that even prior to 1935 the Milwaukee had found it impossible to satisfy this covenant, and entered bankruptcy in that year with vacancies amounting to $5,000,000. The Commission has found (R. 1303) that the reorganized company may not assume the burden of satisfying these defaults or the covenants for future replacements as an unqualified adoption of the lease would require. In the offer

[1] The principal amount of the Terre Haute bonds is substantially in excess of the cost of reproduction less depreciation of the Terre Haute properties as determined by the Interstate Commerce Commission. (R. 2164, 2169, 2212)

to the Terre Haute bondholders they would be required to waive their claims, as all the system creditors are required to do, in respect to existing equipment vacancies. (R. 1330)

Third, the prohibitions in the Terre Haute lease and mortgages against the abandonment of unprofitable mileage which ought to be abandoned in the public interest and in the interest of the property, constitute another burden which may not be assumed by the reorganized company. In the offer it is provided that "The lease shall permit, subject to the approval of this Commission, the abandonment of property which the board of directors may deem to the advantage of the system to abandon, and shall contain such provisions as may be deemed appropriate to facilitate a consolidation of the properties of the Terre Haute with those of the new company." (R. 1331)

Although the Terre Haute contends here that the lease is not burdensome and that the evidence does not support a finding to the contrary, the Terre Haute conceded in the courts below that these burdens are such that the lease in its present form should not be adopted, and must be rejected. The position of the Terre Haute was stated by its counsel as follows:

> "We are willing to have mortgages contain appropriate provisions with reference to the abandonment of obsolete property, * * *. We are willing to take off any undue strain this new company would start out with that it has accumulated in the way of vacancies, and we are willing to ease the load as to future vacancies. We are willing to take off the load of these impending maturities, put them off thirty or forty years." (District Court Transcript, pp. 811-812)

This demonstrates, we believe, how fragile is the attack on the provision in the plan for the rejection of the lease. It is clear, we believe, as the Terre Haute in effect conceded, that these features of the lease standing alone would require its rejection and, therefore, that the attack upon its

rejection must fail. The Terre Haute interests are thus in the position of assailing the Commission's conclusion that there cannot be an unqualified adoption of the lease when they are themselves forced to recognize that the lease has features which are so burdensome that they cannot be adopted.

While recognizing the existence of the burdensome features of the lease to which reference has been made, and agreeing that the lease be modified to remove those burdens, it is the fourth and most compelling reason for the Commission's rejection of the lease which is the basis for the Terre Haute's attack upon that action. The Commission found that to provide for an unqualified adoption of the lease and to pay the Terre Haute, as it demands, the entire lease rental as a fixed charge out of the greatly reduced fixed charge authorized for the system as a whole, would require a substantial sacrifice by the Milwaukee bondholders, which in the Commission's words would be "so entirely inequitable" as to thwart the reorganization of the Milwaukee road. The Commission said:

> "Such rejection is not intended as a threat. It is a necessary step in order that the processes of reorganization of the Milwaukee may not be thwarted. Without rejection of the lease the difficulties of effecting a reorganization, along the lines of the capital structure shown in the approved plan, are evident. The present interest charges on the Terre Haute bonds are approximately $1,023,000 a year. This exceeds the fixed interest requirements in respect of the modified Terre Haute bonds, under the approved plan, by about $420,000. Retaining the present fixed rental payments and at the same time keeping total fixed interest charges to about $4,270,000 a year, as provided in our plan, would thus necessitate reducing the amount of new first mortgage bonds issuable by $10,500,000. Such reduction would mean a substantial sacrifice by the creditors of the debtor who are to receive first-mortgage bonds in part settlement of their claims—a sacrifice in favor of the

> Terre Haute bondholders which, in our opinion, would be entirely inequitable. There would still remain unsettled the matter of the equipment vacancies on the Terre Haute. Under these circumstances we consider that there is no justification for the approval of a plan based upon the assumption by the new company of the lease, the guaranty of the Terre Haute income bonds, and the other obligations growing out of the lease. If the Terre Haute bondholders do not accept the proposals for modification of bonds, etc., a rejection of the lease clearly would be justified in order that the reorganization may proceed according to the plan." (R. 1303-1304)

We have pointed out that the offer to the Terre Haute would give the bondholders of that line full interest (at 4½%) in years when system earnings are $9,675,139, and 70% of its interest as an absolute fixed charge, even in a year in which system earnings should fall to the low level of $2,269,654. But what the Terre Haute bondholders demand is that they receive full interest as a fixed charge even in a year when system earnings are at their lowest ebb.

The purpose of any arrangement, present or prospective, for the operation of the Terre Haute lines as a part of the Milwaukee road is to give the System access to the coal properties reached by the Terre Haute lines. A determination of the true value of access to these coal reserves may not be made in the abstract and without any reference to the earnings of the enterprise which consumes the coal thus made available. It is patent that it would be an intolerable burden to be required to pay the full Terre Haute interest in excess of a million dollars in a year in which system earnings are only sufficient to cover the annual fixed charges of $4,269,000, of which, as stated, only $2,500,000 is available for the publicly held bonds of the entire system. Laboring under such a burden the system would not be operated for the profit of its owners and in the public interest, but primarily as an agency to consume fuel in the interest of the Terre Haute bondholders.

The Terre Haute bondholders contend, however, that by reason of this 999-year lease, and notwithstanding their status in this proceeding as creditors (Sec. 77(b)), they should be immunized against the conditions which have twice brought this system into bankruptcy since the execution of the lease. The reason for this immunity, it is argued, is to be found in what are asserted to be the large earnings of the Terre Haute lines.

The answer to this contention is that the Terre Haute has virtually no earning capacity of its own, and that what loosely, or for convenience, are referred to as the Terre Haute earnings are not in fact the earnings of that line, but are system earnings from traffic which is created and controlled, not by the Terre Haute but solely by the system. The Terre Haute thus has substantial value only as a part of the Milwaukee system. If to realize upon that value it desires to cast its lot with the system, it must in proper degree share the fortunes of the enterprise of which it is a part, and in years of low earnings not be permitted to prosper while the system starves. It is on this ground that the Commission has held that to accord fair treatment to the creditors of the Milwaukee railroad as well as to the bondholders of the Terre Haute, the contributive value of the Terre Haute is not determinable as an abstraction, and without reference to the earnings of the enterprise which consumes the fuel which that line supplies. These are the fundamental considerations which underlie the rejection of the Terre Haute lease in the plan and the offer which is made to the Terre Haute bondholders.

To view this controversy in true perspective, it is necessary to examine the position of the two properties, the 10,000 mile Milwaukee system and the 300 mile Terre Haute, as they were when the lease was made some twenty years ago. To do so shows, first, the fundamental change in the economic position of the system which is operated to cause the lease, improvident when made, to become an in-

supportable burden. It shows secondly, as stated above, that the earnings relied upon by the Terre Haute are in actuality the earnings of the system and not of the Terre Haute.

Under Independent Operation the Terre Haute Was a Distress Property and What Are Now Referred to as Terre Haute Earnings Are In Actuality The Earnings of the Milwaukee System.

In *Investigation of Chicago, Milwaukee & St. Paul Ry. Co.*, 131 I. C. C. 615 (1928), which is incorporated by reference in the Record at pages 1721-2, the Commission made a detailed study of the Terre Haute.[1] Part of its findings are as follows:

> *"That the Terre Haute was a distress property there can be no question.* It was originally a promotion by the late John R. Walsh which collapsed in 1905, involving several Chicago banks. The Chicago clearing-house banks took over the banks [bonds] along with a large block of Walsh securities and other assets which were liquidated as fast as possible. They were unable to realize on the railroad securities. The railroad properties were sold at foreclosure and were acquired by the Chicago, Terre Haute & Southeastern Railway Company of Indiana, which was chartered March 26, 1910." (p. 655)
>
> "Following the reorganization, the Chicago banks had received for their holdings 40 per cent of the income bonds and 40 per cent of the stock of the Terre Haute. The banks were still faced with the problem of realizing on these securities. In 1918 the Continental & Commercial National Bank sold the income bonds which it held, amounting to $595,100 to one of its directors at a price of approximately 20 cents on the dollar. The bank was inclined to sell the lot at a price of less than 10 cents on the dollar, but finally the director paid $8,000 more than the highest outside of-

[1] This was an investigation, initiated by the Commission upon its own motion, of the causes responsible for the 1925-1928 receivership of this property.

fer. The circumstances were such that the greatest care was taken to avoid any suggestion that they were being sold to a director for less than they were worth. It must be considered a fair test of what they were worth. The income bonds had paid very little interest prior to the lease to the St. Paul; in 1918 2.5 per cent; and in 1920 only 1.25 per cent. Its coal cars were obsolete, its locomotives were in poor shape, and it was 'awfully hard up' for working capital. As for the stock the circular issued by the president of the Terre Haute in 1920 to the stockholders with reference to the proposed lease and acquisition of stock recited that the stock 'had during the past 5 years a merely nominal market value of only one or two dollars per share.'" (p. 655)

"The Terre Haute did not occupy any strategic position which would enable it to secure its own terms. Its physical and financial condition had been alluded to; it was a distress property controlled by a committee of Chicago bankers who wanted to liquidate and who had written the securities off the books of their banks at losses; it had no entrance into Chicago; and Byram testified that it was useful to the St. Paul where it would not have been useful to any other railroad, as all the other roads had their own sources of fuel and further 'it was suited to our use and it was not suited to the use of any other property.'" (pp. 657-658)

The Terre Haute climaxed its last six months of independent operation immediately preceding the execution of the lease to the Milwaukee, by a *deficit* of approximately $743,000. It was under these circumstances that the Milwaukee, with a great coal-consuming capacity, and the Terre Haute, an orphan line, with access to extensive coal properties, came together in a joint enterprise. The Milwaukee proceeded immediately by the use of every means in its power to build up coal and commercial traffic for the Terre Haute. It was a work of slow growth. In the 1928 investigation, the Commission's accountants testified that as of June 30, 1925, the total financial burden which had

fallen upon the income of the Milwaukee as a result of the lease was nearly $11,000,000. *Investigation of Chicago, Milwaukee & St. Paul Ry. Co.*, 131 I. C. C. 615, 656. Of this amount, $4,000,000 was the estimated *deficit* to the Milwaukee from the operations of the leased line for the first four years.

Over a period of years, however, substantial traffic was developed for the leased line. The change in the Terre Haute's position from its distress condition prior to the lease is due to the fact that it has now become a fully integrated part of the system. Prior to the lease, the Milwaukee found it economical to buy only 25% of its requirements of Illinois and Indiana coal from the Terre Haute. After the lease, however, 100% of the company coal used in the territory where Illinois and Indiana coal is used has been bought from the mines on the Terre Haute. (R. 1521) The effect of this change on the Terre Haute's revenues is marked. Forty per cent of the Terre Haute's total traffic is Milwaukee company coal. (R. 1696) If the former 25% proportion had been in effect in 1936, for instance, the revenues of the Terre Haute on the tariff rate basis would have been reduced by more than $1,500,000. (Ct. Ex. 16)

Even more important is the fact that other traffic on the Terre Haute would also have been largely nonexistent had it not been for these purchases of company coal. If the Milwaukee ceased to purchase coal from the mines on the Terre Haute, many of them would have to close down because they are marginal mines, and their production of commercial coal is dependent on production of Milwaukee company coal. (R. 1520) Inbound traffic to those communities would also decline as the mines closed down. (R. 1520) The direct dependence of the commercial coal upon the Milwaukee purchases of company coal and the extraordinary steps taken by the Milwaukee to create traffic for the Terre Haute, was strikingly brought out by the

Commission in the 1928 investigation. The Commission said:

> "One of the stated purposes of the St. Paul in acquiring the Terre Haute was to increase the earnings of the St. Paul by the development of commercial coal shipments from mines on the Terre Haute to points on the St. Paul. During the first year of the lease the results were very disappointing, so the following policy was decided upon." (131 I. C. C. at 659)

The policy decided upon, described at length in the report of the Commission, was to apportion company purchases among the Terre Haute mines on the basis of the annual coal shipments of the operators to points on, or via the Milwaukee beyond Chicago. After commenting on the prices paid and kind of coal used, the Commission concluded:

> "* * * we think that the record shows that in a desperate effort to justify the acquisition of the Terre Haute by increasing commercial coal shipments the St. Paul has come perilously near to granting undue concessions to a few large operators on the Terre Haute. It is obvious that in pursuing such a policy price and quality can quickly become secondary considerations as contracts for purchases are traded for revenue business and may even lead to violations of the Elkins Act." (131 I. C. C. at 660).

The commercial demand was for screenings, so the Milwaukee took the lump coal in order to build up the Terre Haute's commercial movement of screenings. The Commission describes this practice as follows:

> "* * * The prices contracted for during the year beginning on April 1, 1925, were 10 to 15 cents per ton higher than those recommended by the chief purchasing officer. Likewise, there is in the record copy of a letter from the chief operating officer of the St. Paul to the chief traffic officer, expressing the opinion that 'we are paying too much of a premium for our coal, and I question if the traffic we get from it would make up the difference.'" (131 I. C. C. at 660)

The commercial coal traffic of the Terre Haute is traffic

created and controlled by the system. Moreover, the Milwaukee has built up for the Terre Haute a "quite substantial interchange on both eastbound and westbound general traffic via Terre Haute gateways," (R. 1519) by securing joint rates with eastern lines, which the Terre Haute, independently operated, had never been able to do. (R. 1519) The record shows that the system has been able to build up and sustain the business of the Terre Haute only by the most intensive efforts of its traffic soliciting forces. (R. 1519) The effect of this may be seen in the fact that prior to the lease, only about 5% of the total Terre Haute traffic was received by it from connecting railroads, whereas now 33% of the total traffic comes from connections. (R. 1699) Coal originated on the Terre Haute accounted for 85% of the total traffic before the lease; now, despite the increase in volume of this coal traffic, it accounts for only 68%. (R. 1698) The Commission found:

> "It may be safely concluded that the earning power of the Terre Haute is sufficient to cover all interest requirements, *but* this earning power is largely dependent on a continuation of the Milwaukee's coal traffic, together with the commercial coal traffic that accompanies it, and would be greatly diminished if such traffic ceased. The present arrangement is distinctly to the advantage of the Terre Haute." (R. 2213)

It is quite indisputable that the earnings claimed by the Terre Haute are actually system earnings obtained and controlled by the aggressive action of the system which the Commission has described. But even as system earnings they are not net earnings. For example, as previously noted, the Milwaukee paid a premium for the lump coal in order to leave the screenings for the commercial demand, and thus obtain the commercial movement. Again, prior to the lease the Milwaukee got the bulk of its coal requirements from other mines, and in return received a great volume of commercial coal traffic from other lines. The Milwaukee lost almost a fifth of this other traffic which it was receiving from the Pennsylvania Railroad and the

C. & E. I. when the lease was made and it shifted its tonnage to the Terre Haute.

The fundamental point is that when the Terre Haute stresses its asserted earnings it seeks to take full advantage of the position which it occupies and can occupy only as a part of the system. It relies upon its membership in the system for the traffic which constitutes its life blood and also to reduce the expenses of handling the traffic thus obtained, and yet it seeks to contend that it should remain wholly unaffected by the profound change which has occurred in the fortunes of the system. Stated in its simplest terms, the Terre Haute is seeking to enjoy the full benefits of its position as a part of the system and at the same time to escape the correlative burdens of that membership.

We direct attention to the vast change which has occurred since the lease was made, in the relationship of the rental to the level of system income available for fixed charges. In the first full year of the Milwaukee's operation of the Terre Haute, the fixed charges of the system were approximately $20,000,000, $19,000,000 of this amount going to the Milwaukee bondholders and less than $1,000,000, or approximately 4½%, of the total system fixed charges going to the Terre Haute bondholders. The total annual fixed charges of the Milwaukee were reduced in the 1925-1928 receivership, with the result that at the beginning of this bankruptcy in 1935 the fixed charges of the system were approximately $14,600,000. The Terre Haute interest charges, which remained undisturbed in that receivership,[1] thus rose from 4½% of the system fixed

[1] In the courts below the Terre Haute emphasized the fact that while the Commission condemned the Terre Haute transaction in its investigation of the 1925 receivership (131 I. C. C. 615) it nevertheless permitted the new company to assume the lease. It should be noted that the road emerged from that receivership in 1928 with fixed charges of $13,663,489, and it was out of fixed charges in that amount that the Terre Haute received its full interest. Under the Commission's offer the Terre Haute would receive full interest when system earnings reach the much lower figure of $9,675,139, and would receive 70% of its interest as a fixed charge out of system earnings of only $4,269,654.

charges as they were in 1922 to 7% of the system fixed charges in 1935. The Commission has now found that the system can pay as fixed charges only approximately one-fifth of the amount of the fixed charges of the property when the Terre Haute entered the system, and the Terre Haute now relies upon earnings which exist only by virtue of its operation as a unit of the system, as the basis for its contention that it should have immunity from the misfortunes of the system. The Commission summarized the situation as it exists today in the language of the then counsel for the debtor, as follows:

> "The problem is succinctly stated by counsel for the debtor in discussing the situation as to the Terre Haute securities in the event we should find that the fixed charges should be substantially less than $6,500,000. He said: 'It may be doubted whether the holders of senior liens upon the debtor's own 10,000 miles of property can be expected to consent to an arrangement which contemplates the continuance of the operation of the 10,000 miles, with no substantial return on their invested capital, merely to provide fuel consumption to support the payment of full fixed interest on the Terre Haute bonds, representing 300 miles.'" (R. 2215-2216)

The bookkeeping tabulations upon which the Terre Haute relies, and discusses at great length in their brief, are superficial and unreal in their relation to this problem if considered by themselves to the exclusion of other evidence. Those accounting statistics do not reflect the fact so peculiar to this situation, that the traffic from which these earnings derive is traffic which is created and maintained by the system—not by the Terre Haute. Such statistical exercises cannot be used to obscure the fact that the Terre Haute is relying upon earnings, which in actuality are the earnings of the system, to obtain priority over the system's creditors. All of these matters were fully considered by the Commission, as shown in its reports. The earnings studies were weighed and applied in the light of these facts, and the Commission pointed out in finding the old lease to be

burdensome, that the Terre Haute "earning power" is dependent upon system traffic, created and maintained by the system. (R. 2213)

In connection with these tabulations the Terre Haute brief makes copious reference to the testimony of Mr. Scandrett, formerly President and now one of the Trustees of the property, and of Mr. Sparrow, formerly Financial Vice President, but fails to explain that their testimony was given in support of the debtor's standby plan. That plan even on the basis of proposed fixed charges of $7,147,146 (R. 24) provided for the rejection of the lease unless the Terre Haute and its bondholders agreed that it be substantially modified.[1]

In support of the contention that the lease is not burdensome, the Terre Haute not only relies upon earnings which are produced by the system, but would ignore the fact that by its terms the lease is to run for 999 years, and all of the considerations which arise out of that fact. One of the important factors in this connection in its long-view implications is a very recent decline which has occurred in the movement of coal over the Terre Haute despite the sustaining influence of its position in the Milwaukee system. The largest annual tonnage of Milwaukee fuel coal transported over the Terre Haute in the seven-year period 1933-39 was approximately 400,000 tons less than the smallest annual tonnage in the period 1924-1929. The average annual tonnage of Milwaukee fuel coal for the years 1933-39 as compared with the years 1924-1929 has decreased by 939,181 tons or 35%. Commercial coal traffic shows a similar decline. (R. 1707-8, Ct. Exs. 19, 21, 23)

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[1] The debtor's former counsel, opposing the payment of the principal of one of the Terre Haute's bond issues, in the District Court in 1938, said:

"Now, your Honor, the plain fact is that this lease must be modified. This debtor cannot live under this lease. The reorganized property cannot go on with this lease." (Transcript of Proceedings, June 20, 1938, pp. 78, 79, 87)

Since the value of the Terre Haute to the Milwaukee lies in the handling of coal traffic, it will be seen that its value has already decreased very substantially. Various economic factors have contributed to this decline in the movement of coal over the Terre Haute, but the greatest peril to that traffic lies (1) in the recent development of Diesel locomotives, which use oil instead of coal, and (2) in the change in industrial methods which promise to cause further important reductions in the shipment of commercial coal. Before 1938, there were only a few Diesel locomotives in use, and then only experimentally. (R. 1515-16) By September, 1940, there were several hundreds of them in use in the United States. (R. 1516) Before 1933 or 1934 there were no Diesels on passenger trains, whereas now there are a "very considerable number." (R. 1516) For example, the Burlington, North Western and Union Pacific now each operate Diesels from Chicago to Denver. (R. 1516)

The Milwaukee's first order for Diesels was for seven locomotives in 1939, the next, in 1940, for sixteen locomotives, and the third for eighteen. (R. 1513-14) Although the locomotives cost about $70,000 apiece, the savings to the Milwaukee from operating them instead of coal-burning engines will pay the entire cost in only eight years. (R. 1513-14) The savings on one item alone may be indicated by the fact that water for locomotives cost the Milwaukee $600,000 in 1939, plus a large amount for maintenance of water stations. (R. 1517) Diesels use "very, very much less" water. (R. 1517)

On April 24, 1941, the District Court authorized the Trustees of the debtor to purchase sixteen more Diesels. (Printed Ct. Rec. p. 8609) The sixteen included locomotives for passenger, freight, road service and switching use. The Trustees' petition stated that the one heavy high speed Diesel freight locomotive would effect annual sav-

ings of $100,000, that the Diesel passenger locomotives can make a round-trip daily between Chicago and Minneapolis, while the steam locomotives can only go one way daily, and that the outstanding saving was in fuel, estimated at ten cents a mile for the passenger locomotives. (Printed Ct. Rec. pp. 8501-6)

In addition to the foregoing factors which threaten additional decreases in the Milwaukee fuel coal traffic of the Terre Haute, there is a threat to the commercial coal traffic of the Terre Haute arising from the development of plants which turn coal into electricity at the mouth of the mine, thus eliminating the transportation of the coal to the point of consumption of the power. (R. 1621)

The future of the Terre Haute traffic and therefore of the Terre Haute itself is, without doubt, problematical. The facts justify the making of another lease of its line only if it can be made upon fair and equitable terms.

The Provision of the Plan for Rejection of the Lease as of the Date of Actual Rejection Is Lawful and Proper.

Conceding that three of the four features of the lease with which the Commission deals require its modification or rejection, the Terre Haute seeks to defeat the plan by attacking the provision in the plan that the rejection of the lease shall take effect as of the date when the court finds that the offer is rejected, if it be rejected. The argument in support of this attack is that there is a fixed and immutable rule in equity that the trustees must account to the lessor for the earnings of the property in excess of the rental paid from the date of bankruptcy. Our position is that (1) there are no such earnings, (2) there is no such rule, and (3) if there were, it would not be applicable to the rejection of a lease by the Commission in the plan, under Section 77.

1. As we have pointed out, what the Terre Haute relies upon as excess earnings since 1935 are actually the earnings of the system. The fact is that the provision in the plan, that if there be a rejection, it should not be dated back to 1935, operates to the advantage of the Terre Haute, as shown by the Commission's report.

The Commission's conclusion from the extensive earning data in the record is that it is not until system earnings reach $9,675,139 that the Terre Haute's contribution to the system entitles it to receive full interest (at 4¼%) on its claim, and that is the basis upon which the Commission has found the Terre Haute is entitled to participate in system earnings in the future. (R. 1330) If that basis were made retroactive to the date of bankruptcy, pursuant to the "relation back" theory urged by the Terre Haute, those bondholders would have received not more but substantially less than the full interest which they did receive. This is because the earnings of the system during those years averaged substantially less than $9,675,139 annually (R. 2180), and, accordingly the Terre Haute's contribution thereto, as the Commission has found, was less than the rental actually paid by the debtor and accepted by the Terre Haute.

Under all the circumstances of the case, the Commission has not required the Terre Haute to make any repayment. It has found that it is fair both to the Terre Haute and to the Milwaukee creditors to permit the amount which has been paid, which constitutes the full interest on the bonds, corporate expenses and taxes, to stand as compensation to the Terre Haute for the operation of the property since bankruptcy.

Neither the Terre Haute nor the creditors of the debtor can fairly contend that this is not a proper basis. The burdens of the lease were such that the Milwaukee was forced to default on the Terre Haute lease in respect to

equipment vacancies as early as July, 1930, five years before bankruptcy. The Terre Haute in the long period that elapsed since those defaults began, made no effort to take back its property. Throughout the 15 years that the lease was in effect prior to 1935 the lessor was content to accept interest on all its bonds, its expenses and taxes, as full rent, and full compensation for the use of its property. The effect of the Commission's order is to continue that basis during the 5-year period in question as constituting a fair and just settlement for the use of the property since bankruptcy.

2. There is no rule of law or equity which required the Commission to reach any different result or which condemns the result which it did reach.

Even if there were excess earnings, as in fact there were not, opposing counsel have not discovered a single case in the books in which any court has ever required a trustee in bankruptcy to pay over to the lessor any amount in excess of the stipulated rent. The Terre Haute contends that *Westinghouse Electric* v. *Brooklyn Transit*, 6 F. (2d) 547, is such a case. Nothing could better illustrate the difficulty under which they labor than their necessity of relying upon that case in an effort to point to at least one decision requiring the trustee to pay over earnings in excess of rental. The facts there, as recognized in the District Court opinion (R. 1882), were that there were not excess earnings in the period following bankruptcy, but a deficit of almost $300,000. During the period of the receiver's operation he did not pay a penny of rent to the lessor. He paid only certain small miscelleanous items such as taxes. The real rent for the period became due on a certain October 1st, and there were no earnings from which to pay it. As the district court stated, "There was nowhere near enough obtained from operation with which to pay the October 1st

quarterly rental." The receiver sought to disaffirm at midnight of the day before this rent was technically due, and then to retain the small excess of income over taxes which had accrued in the previous period. Of course the court would not permit it. Such a situation is a far cry from that here where the Terre Haute bondholders have received the full stipulated rental, namely, their full interest and all corporate expenses and taxes.

There is one case in which the earnings on a leased property indisputably exceeded the rent, and there, contrary to the rule the Terre Haute is seeking to establish, this Court held that the trustee was required to pay only the stipulated rental. This is *Sunflower Oil Company* v. *Wilson*, 142 U. S. 313 (1892). The Terre Haute now argues that this case is not in point. In doing so, it has changed its position from that taken by it in the hearing before the District Court on the Bedford Belt bonds. The Terre Haute stated the rule in their brief, as follows:

> "Where the net earnings from a leased line exceed the amount of the rentals, a trustee or receiver *must pay the agreed compensation for and during the period of his use and enjoyment of the leased property.*

Of the cases cited in support of this position the first is the decision of the Supreme Court in *Sunflower Oil Company* v. *Wilson*. Elaborating upon this principle the Terre Haute stated further:

> "Upon taking possession of the property he (the receiver) was entitled to a reasonable time to elect whether he would adopt this contract and make it his own, or whether he would insist upon the inability of the company to pay and return the property in good order and condition, paying, of course, the stipulated rental for it so long as he used it."

The Terre Haute added: "The essential justice of this rule is apparent."

The Terre Haute does not question the fact that the leading text writers, Finletter, Fletcher and Gerdes[1] deny the existence of the rule for which they contend and state that the maximum liability of the lessor is to pay the rental.

The very cases relied upon by the Terre Haute show that there is no fixed and immutable rule, even when the rejection is by a trustee, which puts the court in a strait jacket in dealing with this question. The rule is simply that equity and justice shall be done under the particular circumstances of each case. This is established by the decisions on which the Terre Haute primarily relies. In the *Westinghouse* case, for example, the court says:

> "This statement seems to us conclusively to show what an idle pother may be made by attempting to inject rigid rules into what is essentially an endeavor to be equitable, *i. e.*, fair—in a receivership accounting." (6 F. (2d) 547, 551)

The Terre Haute devotes more space in its brief to *Palmer* v. *Palmer*, 104 F. (2d) 161, than to any other case, a decision by the Court of Appeals of the Second Circuit. Several of the decisions much cited by the parties, in-

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[1] "The rights of a party to a contract which has been rejected are, usually, * * * second, to the extent that he has rendered performance to the estate during the period of deliberation by the trustee, to claim as a preferred creditor for the fair value of the performance, *not to exceed the stipulated contract rate*, * * *." (*The Law of Bankruptcy Reorganization* (1939) by Thomas K. Finletter.)

"In the absence of anything to show that the amount stipulated in the lease is unreasonable, this amount will be deemed a reasonable rental to be paid for the use and occupation of the premises, *but the receiver should not be held liable for an amount in excess of that reserved in the lease.*" (Section 7794, Fletcher Cyc. of Corporations, Vol. 16 (1933)).

"If a receiver or trustee rejects a lease in an equity receivership or bankruptcy proceeding, the lessor has a claim against the estate * * * up to *an amount equal to the rental stipulated in the lease.*" (*Gerdes, Corporate Reorganizations*, Vol. II, Sec. 697 (1936)).

The rule is similarly stated by Clark, Foley and Shaw in *Adoption and Rejection of Contracts and Leases by Receivers*, 46 Harv. Law Review, 1111, 1134, 1135.

cluding that in the *Westinghouse* case, are by that court. In the face of the Terre Haute's basic contention here that the effective date of the rejection as fixed by the Commission runs counter to a fixed and immutable rule of the equity courts, it is interesting to see what that court has said about its own several decisions respecting the existence of such a rule:

> "We have considered the question three times, and the results were not harmonious." (p. 163)

Even more significantly the court says this:

> "• • • the trustee need not pay the rent during the probationary period, and the court will hold off the lessor, and force him to be content with the value of the use and occupation meanwhile, *though ordinarily it will fix that at the same amount as the rent.*" (p. 163)

This is exactly what the Commission did here; and yet the case is relied upon as showing the error of the Commission's action. Again, in reaching its conclusion the court says, "We need not lay down an inflexible rule; • • •." (p. 164)

It will be seen that to the extent that any rule can be said to exist, the rule is that the trustee may always discharge the full obligation upon him by paying the rent which the lessor had agreed to accept. But that is simply because it is ordinarily the fair disposition of the matter. The basic and essential rule, and the only principle which unifies all of the decisions on the question, including those of the Second Circuit Court of Appeals, is the rule that justice shall be done on the facts of the particular case. We submit that the Commission has done justice in finding that the accounting for the past should rest where it now stands, payment having been made of full interest to the bondholders and of all corporate expenses and taxes.

3. But even if there were such a rule as that contended for, and the cases cited by the Terre Haute show

that there is not, it would not be binding upon the Commission or the Court in a proceeding under Section 77 of the Act, the rejection being not by the Trustee, but, in effect, a legislative act.

Subsection (b) of Section 77 contains the following provisions:

> "(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (5) shall provide adequate means for the execution of the plan which may include * * * the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, * * *; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this Section." (11 U. S. C. A. Sec. 205 (b))

Paragraph (b) thus provides that the plan "shall include provisions modifying or altering the rights of creditors." The Terre Haute bondholders are creditors of the debtor as defined in the Act,[1] and all other creditors have suffered innumerable modifications of their rights.

The same paragraph provides that the plan "may reject unexpired leases." As the Terre Haute states:

> "Section 77 itself contains no express provision covering the period of operation prior to the time when the determination to reject is reached." (Terre Haute Brief, p. 39)

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[1] Section 77(b) provides in part as follows:

"The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease."

But Section 77, after empowering the Commission to provide in the plan to "reject unexpired leases" immediately continues with the declaration that the plan "may include other appropriate provisions not inconsistent with this section." Fixing the effective date of the rejection is an incident of the unqualified power to provide in the plan for the rejection of a lease.

To import into Section 77 a rule of equity which in fact does not exist, to govern the disposition of earnings in excess of rental which were in fact not realized, the Terre Haute relies upon the following language in paragraph (b) of Section 77:

> "In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor *to the extent of the actual damage or injury* determined *in accordance with* principles obtaining in equity proceedings." (11 U. S. C. A. Sec. 205 (b))

Under that section, the lessor is deemed to be a creditor of the debtor only to the extent of the "actual damage or injury." Even the Terre Haute is not contending that its claim for excess earnings constitutes compensation for any "actual damage or injury" to it. Instead, the payment by the Trustees of the large amount of money demanded by the Terre Haute would bring it a pure windfall of profit. It would not be compensation for damage or injury, and would be an unwarranted preference of the Terre Haute over the other system creditors.

To import the alleged "relation back rule" into Section 77, the Terre Haute's reliance is upon the words "in accordance with" in the last sentence of the provision quoted above. A similar contention respecting the same provi-

sion was overruled by this Court in *Connecticut Railway v. Palmer*, 305 U. S. 493 (1939). The Court stated the issue as follows:

> "The determination depends upon the meaning of the definitive clause 'to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings.'" (p. 494)

It was contended that this provision imported into Section 77 a rule of damages obtaining in equity receiverships. Overruling that contention the Court said:

> "As reorganizations had been traditionally carried on in equity and would be carried on in a bankruptcy court with equity powers, it was natural to add the clause as to equitable proceedings." (p. 502)
>
> "The reference to equity proceedings does not, in our opinion, refer to any rule for the measure of damages in equity receiverships." (p. 503)

Even if the Terre Haute were able to establish the existence of the rule for which it contends, the rule has not become a part of Section 77 and would not govern a rejection by the Commission in the plan of reorganization.

The Offer Which the Plan Tenders to the Terre Haute Bondholders Represents a Sound and Commendable Effort by the Commission to Deal Constructively With the Terre Haute Problem.

Every party to this proceeding agrees that in the interest of both properties the Terre Haute lines should be retained as a part of the Milwaukee system. In their brief the Terre Haute interests state:

> "The only conclusion which can be reached is that the Terre Haute and the Milwaukee are each very important to the prosperity of the other." (Terre Haute Brief, p. 21)

The General Mortgage interests urged that a new lease should be made for an "adequate consideration." The Commission was of the same view. Since any lease or operating arrangement which might later be proposed

by the parties must be approved by the Commission under Section 5 of the Interstate Commerce Act, the Commission on the complete record before it deemed it to be its duty, while providing for the rejection of the existing lease, to deal constructively and definitely with the problem by stating in the plan, the terms upon which it would authorize the continued operation of the Terre Haute lines by the reorganized company. The Commission said:

> "We have been and remain strongly of the opinion that the plan should provide some means for retaining the Terre Haute lines as a part of the system without unduly jeopardizing a successful reorganization of the Milwaukee." (R. 1303)

The problem was to provide a basis for such an arrangement which would accord fair treatment to the Terre Haute without prejudicing the financial rehabilitation of the debtor. The Commission stated its conclusions as follows:

> "Under the circumstances, we shall approve as part of the plan, provisions for dealing with the Terre Haute bonds in a manner which bears a fair and equitable relationship to the treatment accorded the bondholders of the debtor, does not require a consolidation of the properties, and yet accords to the Terre Haute bondholders the same security under the existing mortgage, respectively, as their present bonds hold. However, these provisions, in order to become an effective part of the plan, will have to be accepted by substantially all of the Terre Haute bondholders." (R. 2216)

The District Court permitted the introduction of additional evidence by the Terre Haute and all interested parties (R. 1684-1722) and fully considered, and in its opinion discussed, all of the technical objections advanced by the Terre Haute in their effort to block the possibility of rejection of this burdensome lease. On the basis of the entire record the Court concluded:

> "The Court feels that the Commission, in dealing with the Terre Haute interests, handled a difficult situation in a very creditable manner and evolved a

Plan which is fair and equitable, all things considered." (R. 1885)

We respectfully ask this Court to sustain that holding.

C. Brief of Certain Adjustment Mortgage Bondholders.

The holders of $31,500 of Adjustment Mortgage bonds have filed a brief in support of their contention that the provision for those bonds in the plan is "discriminatory, unfair, inequitable, and in violation of the Fifth Amendment." (Abrams Brief, p. 7) The only arguments advanced by these bondholders that are not raised by other respondents are: (1) Accrued interest up to the effective date of the plan should have been allowed on the Adjustment bonds; and (2) The voting trust provided for the new stocks in the plan is illegal under Illinois law.

The decision of this Court in *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, 412 (1938) answers the first contention. Since the distribution provided for the Adjustment bondholders on the basis of their mortgage security is less than the principal amount of their claim the Commission, in strict conformity with the *Ticonic Bank* decision, allowed these bondholders to share the unmortgaged assets ratably with the unsecured creditors on the basis of principal and interest up to bankruptcy only. (R. 2257)

As to the contention that a voting trust is illegal under Illinois law, it should be noted that the debtor is incorporated under the law of Wisconsin. (R. 2)[1] But even if Illinois law were to be controlling, *Babcock* v. *Chicago Rys. Co.*, 325 Ill. 16, 155 N. E. 773 (1927) is conclusive against

[1] It should also be noted that Section 77 (f) provides that "Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan * * *, the laws of any State or the decision or order of any State authority to the contrary notwithstanding.",

the contention. There, in upholding the legality under Illinois law of a voting trust *in the reorganization plan* for the Chicago Railways Company, the court stated that it "was made to protect the rights not only of the holders of the participation certificates but of all the other interested parties to the transaction." (p. 31) Here the voting trust is an integral part of the plan and is necessary, as both the Commission and the District Court found, not only in the interest of the parties, but also in the public interest.

D. Brief of the Trustee of the Chicago, Milwaukee & Gary Mortgage.

This brief raises once again the contentions as to the value of the Gary lines on the basis of their contribution to the system, earning power, reproduction cost and scrap price. The thorough consideration of all of these factors by the Commission was discussed on pages 94 to 97 of our original brief.

CONCLUSION.

We ask that this Court reverse the decision of the Circuit Court of Appeals and direct affirmance of the approval by the District Court.

Respectfully submitted,

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APPENDIX A.

RECORD REFERENCES TO EVIDENCE INTRODUCED BEFORE COMMISSION AND DISTRICT COURT, RESPECTIVELY, AS THE BASIS OF THEIR DECISIONS CONCERNING CAPITALIZATION AND CAPITAL STRUCTURE OF REORGANIZED COMPANY, LACK OF VALUE OF STOCK, PERMISSIBLE FIXED CHARGES, ADDITIONS AND BETTERMENTS FUND, AND ALLOCATION OF NEW SECURITIES.

1. CAPITALIZATION AND CAPITAL STRUCTURE OF REORGANIZED COMPANY.

(A) EVIDENCE INTRODUCED BEFORE THE COMMISSION:

(i) Past earnings:

Report of Commission's Bureau of Accounts, dated June 13, 1936, pursuant to Section 77(c)(11).

Collection of record showings for various years. (Com. Exs. 175, pp. 10, 57; 182, 183)

(ii) Estimates of future earnings and earning capacity:

The first estimate of future earnings and earning capacity was presented to the Interstate Commerce Commission at the hearing on August 6, 1935, by W. W. K. Sparrow, vice president of the debtor, in charge of finance, accounting and real estate. The estimate introduced by Mr. Sparrow was assigned Com. Ex. No. 96. Debtor's counsel in presenting that study stated that Mr. Sparrow "has done what the expert, who says he is making a forecast, usually does." (R. 352) Mr. Sparrow testified that:

> "The best I am able to do is to take past earnings, modify them for such known changes as have taken place, and make assumptions that seem reasonable, * * *." (R. 353)

The methods employed by Mr. Sparrow in making his studies are described by him in detail at R. 352-361.

At the hearing before the Commission on June 16, 1937 Henry A. Scandrett, one of the Trustees of the property

and president of the debtor, put in evidence a forecast of earnings which was prepared by the officers of the company under his direction. (Com. Ex. No. 121; R. 558) The methods used in making the study presented by Mr. Scandrett are described by him at R. 558-564.

After careful study and investigation by its chairman, the Group of Institutional Investors adopted as sound the assumptions upon which the debtor's 1935 estimate had been made. (R. 733, 735) The chairman of the Group, Frederick W. Walker, presented at the hearing on February 1, 1938, before the Commission, Com. Exs. Nos. 177, 179, which are entitled "Committee's Forecast for the Future Average Normal Year." These studies are described in detail by Mr. Walker at R. 731-737.[1]

(iii) Elements of Physical Value:

In addition to the reports prepared by Commission's Bureau of Valuation, dated August 5, 1936, and November 14, 1936, the debtor introduced several exhibits stating and explaining the elements of value. (Com. Exs. 113, 185, 186) The Coordinating Engineer for the Bureau of Valuation explained the nature of the studies prepared by that Bureau. (R. 954-5)

(iv) Annual reports for years 1921-1936, and explanation thereof and analysis of changes from year to year by debtor's president. (Com. Exs. 98-104, 118-9, 160-3; R. 439-450, 550-8, 638-641, 1028-33)

(v) Traffic and operating studies by the officials of the road and others, as follows:

Freight density charts. (Com. Ex. 77)

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[1]Of record also are two traffic studies embodied in the special reports of the Bureau of Finance Accountants of the Interstate Commerce Commission, one of which, dated April 15, 1937, deals with the debtor's freight traffic and the other of which, dated June 5, 1937, deals with the debtor's railway operating revenues other than freight. Although these reports do not present any specific forecast of earnings they do contain much basic information essential to a reliable judgment as to the future.

Freight commodity statistics. (Com. Ex. 116)

Statistics of operation for 1925, 1926, and 1927. (Com. Exs. 164, 165, 166)

Operating revenues 1921-37. (Com. Ex. 178)

Freight revenues and tonnage by commodities 1936. (Com. Ex. 149)

Groups of revenue and tonnage of commodities 1928-1936. (Com. Ex. 150)

Average net tons per train, traffic units, etc. 1902, 1924, 1929 and 1936. (Com. Ex. 152; R. 608)

Gross operating revenues, etc. 1883, 1929, 1936. (Com. Ex. 153)

Statement of debtor's president as to consist of traffic. (R. 513-516)

Variations in principal commodities carried 1928 to 1936. (R. 585)

(vi) Special studies as to taxes, payroll reductions and freight surcharges. (Com. Exs. 133, 134, 147, 148; R. 569, 1035)

(vii) Special studies as to status of equipment, investments in affiliated companies, and revenues, expenses and net income from branch lines. (Com. Exs. 97, 112, 114, 123, 138)

(viii) Equity receivership (1925-28) and testimony of debtor's president regarding need for reorganization. (R. 257, 456-8, 617)

(ix) Plans Submitted:

Debtor's 1935 Plan and development thereof. (Com. Ex. 1; R. 458-469)

Group of Institutional Investor's Plan and principles followed therein. (Com. Ex. 175; R. 724-5)

Debtor's Suggested Modifications to Group's Plan. (Com. Ex. 189)

(B) EVIDENCE INTRODUCED BEFORE THE DISTRICT COURT:

Little effort was made by objectors or others to challenge, modify or expand the exhaustive record introduced before the Commission and certified to the District Court concerning the permissible capitalization and capital structure for the reorganized company. Dr. J. H. Parmelee, Director of the Bureau of Railway Economics of the A sociation of American Railroads testified at the hearings before the Court on September 5, 1940. (R. 1566-1664) While he did not present any complete or formal study, he testified orally concerning his opinion as to future earnings. (R. 1563-1583ff) The substance and effect of Dr. Parmelee's testimony is stated by the District Court at R. 1873-4. Evidence as to the elements of physical value and as to the cost of reproduction was also introduced. (Ct. Exs. 9, 10-12; R. 1537-1561)

2. LACK OF VALUE OF STOCK.

(A) EVIDENCE INTRODUCED BEFORE THE COMMISSION:

The evidence as to permissible capitalization for the reorganized company covered in No. 1 above of this Appendix A, was also considered by the Commission in finding the present stock to be without value, as its report shows. In addition the following evidence was introduced before the Commission relating more particularly to the lack of value of the stock:

(i) Amount of debt, and comparison of debt in 1928 and 1935. (Com. Ex. 105, 131)

(ii) Income available for 14-year period 1921-1934 and comparison with present interest requirements and income estimated to be available in the future normal year. (Com. Ex. 182)

(iii) Capitalization of income available for interest and comparison with present debt. (Com. Ex. 184)

(iv) Analysis of position of present stockholders on

basis of earnings record and earning capacity and physical value of property. (Com. Exs. 182-187; R. 787-792)

(v) Studies concerning coordinations. (Com. Ex. 207-210)

(B) EVIDENCE INTRODUCED BEFORE THE DISTRICT COURT:

(i) Preferred stock committee's showing as to earning power of property. (R. 1665-1677)

(ii) Operating income account for year ended July 31, 1940, compared with year ended July 31, 1939. (Ct. Ex. 13)

(iii) Operating efficiency factors 1921-1940 and studies concerning coordinations. (Com. Ex. 14)

3. PERMISSIBLE FIXED CHARGES.

(A) EVIDENCE INTRODUCED BEFORE THE COMMISSION:

(i) Fixed charge level in past years. (R. 262, 724-735, 913)

(ii) Factor of uncertainties in earnings. (R. 618)

(iii) Report on examination made for the Group of Institutional Investors, on minimum level of earnings to be used as basis of determination of permissible fixed charges. (Com. Ex. 185; R. 758-9, 946)

(iv) Group of Institutional Investor's proposal of fixed charge level. (Com. Ex. 175, pp. 11, 13)

(B) EVIDENCE INTRODUCED BEFORE THE DISTRICT COURT:

Statement of operating revenues and income available for fixed charges 1926-1940, inclusive. (Ct. Ex. 5)

4. ADDITIONS AND BETTERMENTS FUND.

(A) EVIDENCE INTRODUCED BEFORE THE COMMISSION:

(i) Requirements in various past years for additions and betterments. (Com. Ex. 121; R. 355-6, 362-3, 429-30, 895-903)

(ii) Explanation of additions and betterments expenditures by debtor's president. (R. 451-4)

(iii) Retirements charged to operating expenses and depreciation charges. (R. 895)

(iv) Statement showing development of additions and betterments modification. (Com. Ex. 190)

(v) Working capital necessary. (R. 569-70)

(vi) Reason for mandatory additions and betterments fund. (R. 1049)

(B) EVIDENCE INTRODUCED BEFORE THE DISTRICT COURT:

(None)

5. ALLOCATION OF NEW SECURITIES.

(A) EVIDENCE INTRODUCED BEFORE THE COMMISSION:

(See also No. 1 above of this Appendix A, since the evidence as to the permissible capitalization and capital structure necessarily affects the allocation of new securities.)

(1) Ascertainment of amount and nature of each class of claims.

(i) Evidence prepared by the Commission's staff pursuant to Section 77(c)(11):

Statement attached to Report of the Bureau of Valuation on elements of value of debtor's railroad property and separately by mortgage divisions, dated August 5, 1936, as modified by the statement attached to the Supplemental Report of the Bureau of Valuation, dated November 14, 1936. (R. 542, 544)

(ii) Evidence presented by the debtor:

Statement of outstanding securities. (Com. Ex. 71)

Statement of outstanding unsecured obligations and claims. (Com. Exs. 72, 115, 135, 136, 170; R. 746-7)

Mortgage, note or lease securing each class of secured claim. (Com. Exs. 15-68)

(2) Ascertainment of properties subject to the lien of each mortgage division.

(i) Evidence presented by the debtor:

Description of properties subject to lien of different mortgages. (Com. Ex. 73; R. 292-6)

Statement of equipment trust agreements. (Com. Ex. 74)

Mortgage map showing lien positions of each of the debtor's securities. (Com. Ex. 75; R. 292)

(3) Valuation of each class of claims.

(a) Physical valuation.

Evidence prepared by the Commission's staff pursuant to Section 77(c)(11):

(i) Report of the Bureau of Valuation on Elements of Value on debtor's railroad property as whole and separately by mortgage divisions, dated August 5, 1936, as modified by the Supplemental Report of the Bureau of Valuation, dated November 14, 1936. (R. 542-544)

(ii) Evidence presented by the debtor and parties:

Commission's final valuation for rate-making purposes continued to June 30, 1935, with breakdown thereof as between the property subject to the respective liens of the several mortgages. (Com. Ex. 76; R. 297-300, 420, 740-741)

Value of Milwaukee Land Company, stock of which is held free of mortgages. (R. 491, 2260)

Scrap value of Western lines. (R. 900-7)

Special showing as to value of R. F. C. collateral. (Com. Exs. 199-203)

(b) Determination of earning power.

(i) Evidence prepared by the Commission's staff pursuant to Section 77(c)(11):

Freight Traffic Studies prepared by Loan and Reorganization Sections of Bureau of Finance, dated November 16, 1936, consisting of 101 schedules analyzing in statistical form each principal commodity transported by the debtor railroad. (R. 549)

Report of Bureau of Finance Accountants on

Freight Traffic, dated April 15, 1936, consisting of 78 pages of comments upon and analysis of traffic trends, movements of traffic to and from each of the territories, the possibility of exhaustion and duration of production, the effect of competitive transportation agencies and numerous other factors. (R. 549)

Report of Bureau of Finance Accountants, dated June 5, 1937, on railway operating revenues other than freight. (R. 547)

(ii) Evidence presented by the debtor and parties:

Map showing Milwaukee & Northern R. R. and connections with other roads. (Com. Ex. 78; R. 302)

Carload traffic handled on lines subject to the lien of Milwaukee & Northern mortgages during the year ended September 30, 1933. (Com. Ex. 80; R. 303-310)

Estimated net income for the lien subject to the lien of the Milwaukee & Northern R. R. for the year ended September 30, 1933, and year 1934. (Com. Ex. 81; R. 310)

Earnings of Chicago, Milwaukee & Gary as a separately operated property, together with its contributions to the system. (Com. Ex. 85; R. 311-319)

Rockford properties of Chicago, Milwaukee & Gary. (Com. Ex. 86; R. 321-322)

Rockford earnings of Chicago, Milwaukee, St. Paul & Pacific. (Com. Ex. No. 87; R. 322-324)

Map showing Terre Haute Lines and connections with other roads. (Com. Ex. 88; R. 325-327)

Revenues, expenses and net income of Terre Haute Lines for years 1925 and 1926. (Com. Ex. 89; R. 327)

Revenues, expenses and net income of Terre Haute Lines for years 1933 and 1934. (Com. Ex. 90; R. 332)

Map showing lines of railroad subject to the liens of the First and Refunding and Fifty Year Five Per Cent. Mortgages. (Com. Ex. 91; R. 334-336)

Statement by debtor's president that studies prepared make "allocation of the actual earnings of the property, as presently operated," and do not assume "separate operation." (R. 574-5)

Net income available for interest on lines subject to the liens of the First and Refunding and Fifty Year Five Per Cent. Mortgages (1931). (Com. Ex. 92; R. 337)

Net income available for interest on lines subject to the liens of the First and Refunding and Fifty Year Five Per Cent. Mortgages (1930). (Com. Ex. 93; R. 344-345)

Revenues, expenses and net income of Terre Haute Lines for the year 1936. (Com. Ex. 139; R. 575-578)

Rules governing the preparation of separate records to show result of operation of Chicago, Terre Haute & Southeastern Railway. (Com. Ex. 140; R. 575-578)

Estimated replacement value of Terre Haute equipment vacancies as of December 31, 1937. (Com. Ex. 168)

Estimated revenues, expenses and net income of Milwaukee and Northern Lines for Year 1936. (Com. Ex. 141; R. 578)

Method used in arriving at earnings of Milwaukee and Northern Lines for Year 1936. (Com. Ex. 142; R. 578-580)

Estimated revenues, expenses and income of the Chicago, Milwaukee and Gary Line and its contribution to the system (year 1936). (Com. Ex. 143; R. 580-581)

Method used in arriving at earnings of Chicago, Milwaukee and Gary for year ended December 31, 1936. (Com. Ex. 144; R. 580-581, 784)

Estimated income available for interest on lines which are subject to the liens of the First and Refunding and Fifty Year Five Per Cent. Mortgages for year 1936. (Com. Ex. 145; R. 581-584, 715-716, 778)

Method used in arriving at income available for interest for lines and properties subject to liens of First and Refunding and Fifty Year Five Per Cent. Mortgages for year 1936. (Com. Ex. 146; R. 581-584)

Voluminous testimony of two expert witnesses on behalf of Fifty Year Five Per Cent. Mortgage bonds. (R. 990-1018, 1090-1128)

Estimated revenues, expenses and net income of Milwaukee & Northern Lines for the year 1936, with estimated separation between lines subject to the respective liens of the two Milwaukee & Northern Mortgages. (Com. Ex. 156; R. 699-700, 709-716, 768)

Revenues, expenses and net income of Terre Haute lines on a cost of service basis. (Com. Ex. 157; R. 701-703, 744-751)

Estimated income of General Mortgage lines available for interest on equipment obligations and other funded debt. (Com. Ex. 158; R. 703, 704, 773)

Summary of allocation made by debtor of actual system earnings for year 1936, to mortgage districts, in designated exhibits, with various adjustments made by debtor separately shown, together with interest requirements. (Com. Ex. 180; R. 766)

Allocation made by debtor of actual system earnings for year 1936 to mortgage districts, in designated exhibits, with various adjustments made by debtor separately shown, together with interest requirements. (Com. Ex. 181; R. 771-772)

(c) Consideration of value to system.

Freight density charts of lines subject to the several mortgages. (Com. Ex. 77; R. 300)

Milwaukee & Northern lines are "contributing a very profitable volume of traffic to the other lines of the System." (R. 263, 492)

Statement of business contributed by western lines to balance of system. (Com. Ex. 145)

Estimate by debtor's vice-president in charge

of finance and accounting of the revenues obtained by the general mortgage lines from traffic originating or terminating on lines west in 1930 and 1931. (R. 343-344, 781)

Evidence of each of the several claimants for special consideration of their particular facts not reflected in the several segregation statements and earnings studies is spread throughout the entire record before the Commission.

(B) EVIDENCE INTRODUCED BEFORE THE DISTRICT COURT:

Evidence introduced before the District Court dealt largely with the value of the several mortgage divisions and classes of claims, as follows:—

Statement showing R. F. C. loan as of September 1, 1940, collateral pledged with and cash held as security for such loan. (Ct. Ex. 27)

Estimated revenues, expenses and net income of Milwaukee and Northern lines for 1937, 1938 and 1939. (Ct. Exs. 28, 29, 30; R. 1722-1727)

Formula governing the segregation of revenues, expenses and income of the Milwaukee and Northern lines. (Ct. Ex. 31)

Estimated revenues, expenses and net income of Terre Haute Lines, computed as a separate carrier and also on a cost of service basis for various years. (Ct. Exs. 16-23; R. 1684-1714)

Increasing use of Diesels. (R. 1513-1517, 1775)

Decline in use of fuel coal and commercial coal. (Ct. Exs. 19, 21, 23; R. 1707-8)

Commission's reports of investigation and reorganization in 1925-1928 proceeding in 131 I. C. C. 615 and 131 I. C. C. 673 incorporated by reference. (R. 1721-1722)

Statement of Terre Haute equipment vacancies as of June 30, 1940. (Ct. Ex. 24)

Terre Haute corporate expenses, year 1939. (Ct. Ex. 25)

Map showing Terre Haute Lines. (Ct. Ex. 15)

Segregation of system income to lines west, etc. 1935-1938. (Ct. Exs. 34, 36; R. 1779-1793)

Estimated salvage value and other elements of value of properties subject to lien of the Chicago, Milwaukee and Gary Mortgage. (Ct. Ex. 33; R. 1757-1772)